Hans Hoogervorst  
International Accounting Standards Board  
1st Floor  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

Technical Director  
File Reference Number 2011-230  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116  
USA

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Dear Sir/Madam

IASB Exposure Draft ED/2011/6 Revenue from Contracts with Customers and FASB Proposed Accounting Standards Update (Revised) Revenue Recognition (Topic 605) – Revenue from Contracts with Customers (including proposed amendments to the FASB Accounting Standards Codification)

We appreciate the opportunity to respond to the revised Exposure Draft, Revenue from Contracts with Customers (Revised Exposure Draft), issued by the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) (together, the Boards). We have consulted within the KPMG network in respect of this letter, which represents the views of the KPMG network, including KPMG LLP (U.S.). This letter is being submitted to both the IASB and the FASB.

We continue to support the Boards’ efforts to develop a single revenue recognition model that can be applied to transactions across industries, would eliminate industry and transaction-specific U.S. GAAP guidance that would be inconsistent with the model, and would provide more guidance than currently exists in International Financial Reporting Standards (IFRS). We generally support the broad principles of the proposed model.

In order to meet the Boards’ objective to develop a common revenue recognition standard that can be applied in a consistent manner under U.S. GAAP and IFRS across entities, industries, jurisdictions, and capital markets, it is critical that the new standard clearly articulates the broad principles to provide an appropriate framework for implementation of that model. While the Boards have made significant progress in the Revised Exposure Draft, we believe that the
operationality of the final standard, and the consistency with which it will be applied in practice, will be enhanced if certain of the proposed principles and requirements are clarified.

In that regard, our key areas of concern are as follows:

- **Identifying separate performance obligations** – Additional clarification is needed regarding (i) the definition of distinct for multiple units of repetitive service, (ii) the use of the practical expedient for combining multiple distinct goods or services into a single performance obligation and (iii) the application of the criteria for determining whether goods or services are highly interrelated and require an entity to provide a significant service of integrating the goods or services. Clarification in these areas is important both for application of the proposed revenue recognition model and also to ensure that the proposed onerous test is applied in a consistent manner.

- **Performance obligations satisfied over time** – The Boards should clarify the requirements in paragraph 35(b) and link them more closely to the overall transfer of control concept. We believe that this would enhance the operationality of the final standard and improve the consistency with which entities determine which performance obligations are satisfied over time.

- **Costs to fulfil performance obligations satisfied over time** – The guidance in the Revised Exposure Draft may not be sufficient to promote consistent cost accounting, particularly in respect of performance obligations that are satisfied over time. Although we agree that the final standard does not need to address all areas related to accounting for costs, we believe that the Boards should consider whether it is necessary to develop further guidance to fill any ‘gaps’ created by the withdrawal of existing standards.

- **Financial services transactions** – We believe there should be more specific consideration of different types of transactions in the financial services industry, such as how the proposal would be applied to depositor services (e.g., cheque processing or ATM services) and provide additional clarification on how these types of transactions would be accounted for under the Revised Exposure Draft.

We explain these key concerns below. In addition, we have responded to the Boards’ questions and have identified other important areas that we believe warrant consideration by the Boards. Appendix A contains our responses to the questions posed in the Revised Exposure Draft. Appendix B provides additional issues that we believe the Boards should consider before finalising the standard. Appendix C provides our comments on the proposed Amendments to the FASB Accounting Standards Codification™ (ASC). Appendix D provides our comments on proposed Amendments to other IFRSs.
Identifying Separate Performance Obligations

Unit of Account for Performance Obligations Satisfied Over Time

The Revised Exposure Draft indicates that an entity transfers control of a good or service over time and, thus, satisfies a performance obligation and recognises revenue over time when certain criteria are met. However, in situations that require a vendor to provide multiple units of a repetitive service, further clarity is needed to clarify which units of service in the contract would be considered distinct and, thus, separate performance obligations. If a vendor regularly sells a unit of service separately, it is clear that that unit of service is distinct. However, if the vendor does not sell a unit of service separately, it is less clear how the vendor would evaluate whether a customer can benefit from the unit on its own or together with other resources that are readily available to the customer.

For example, consider market research or other data analysis companies that provide customers with a subscription-based product for a three-year period and do not offer or provide subscriptions for terms less than three years. While a three-year subscription is sold separately and clearly would be distinct, it is not clear whether some unit of service less than three years also would be distinct. In a literal sense, a customer could benefit from a relatively short unit of service, such as a day. As an additional example, consider a professional services company that provides a consulting service aimed at generating cost savings for a customer. The consultant expects that the project will span a period of two years. These types of consulting arrangements typically span a period of more than one year, but in a literal sense, a customer could benefit from a relatively short unit of service, such as an hour.

The determination of the number of performance obligations resulting from multiple units of a repetitive service and the duration of the respective performance obligation(s) will have consequences when applying the onerous test and accounting for contract modifications. Without further clarification, unintended diversity in practice is likely to evolve.

The Revised Exposure Draft indicates that the onerous test is performed for each performance obligation that an entity expects at contract inception will be satisfied over a period of time greater than one year. Hence, if the market research or other data analysis service described in the above example is considered to be a single three-year performance obligation or the consulting service is considered to be a single two-year performance obligation, then it would be within the scope of the onerous test. However, if the market or other data analysis service or consulting service is considered to be multiple performance obligations that each span one year or less, those performance obligations would not be within the scope of the onerous test.

When a contract is modified to add increments of a repetitive service to the contract, the accounting for that modification first hinges on whether the added service is distinct. If the added service is distinct, then the modification is accounted for either as a separate contract if the additional consideration to be received reflects the entity’s standalone selling price for the additional services, or prospectively on a combined basis with the original contract if the
additional consideration is not reflective of the standalone selling price of the additional services. If the added service is not distinct from the original service, then the modification is accounted for by updating the transaction price and measure of progress toward complete satisfaction of the performance obligation with any adjustment reflected on a cumulative catch-up basis. Example 2 — Modification of a services contract in the Revised Exposure Draft indicates that a modification that adds three years of service to an existing service arrangement would be distinct. However, it is unclear from the example whether the addition of any incremental service would be distinct. Consider the example of the cost savings consulting service described above. Assume that during the course of the consulting arrangement, the consultant agrees to provide the customer with an additional 20 hours of related service at a larger than normal discount. It is unclear whether the addition of 20 hours of time to a two-year consulting contract would always be considered distinct and, thus, accounted for prospectively or would be combined with the original service and accounted for on a cumulative catch-up basis.

Practical Expedient for Combining Multiple Distinct Goods or Services

The Revised Exposure Draft includes a practical expedient that allows multiple distinct goods or services to be accounted for as a single performance obligation if those goods or services have the “same pattern of transfer to the customer” (emphasis added). However, the second sentence of paragraph 30 in the Revised Exposure Draft includes an example that indicates that two or more services transferred “over the same period of time” (emphasis added) may be accounted for as one performance obligation if applying one method of measuring progress would “faithfully depict the pattern of transfer of those services”. Additionally, Example 13 — Management fees in the Revised Exposure Draft indicates that consecutive increments of service have the same pattern of transfer and could be accounted for as a single performance obligation by applying the practical expedient. The guidance is not clear as these three references appear to be using different concepts for determining when the practical expedient could be applied.

Consider a software vendor that enters into a one-year post-contract customer support (PCS) contract which includes upgrades and enhancements and telephone support with a customer. Assume that the upgrades and enhancements and telephone support are distinct performance obligations. Upgrades and enhancements will be transferred to the customer when and if they become available. Telephone support will be provided throughout the period on an ‘as needed’ basis. The pattern of transfer of these two services will likely be different, but the services are provided over the same period of time and both would be viewed as ‘stand-ready’ performance obligations. As drafted, the Revised Exposure Draft is not clear whether the use of the practical expedient in the above example would be appropriate. We believe the final standard should be clarified to allow for the application of the practical expedient in such situations.

In addition, if the Boards intend for the practical expedient to apply to consecutive increments of service as Example 13 indicates, then it is not clear how the practical expedient interacts with the scope of the onerous test, similar to our concern noted above regarding the unit of account for performance obligations satisfied over time. Paragraph 86 indicates that the onerous test
applies to performance obligations satisfied over a period of time greater than one year. However, paragraph 30 states that an entity “may account for two or more distinct goods and services...as a single performance obligation”, not that the distinct goods and services are a single performance obligation. We believe the final standard should clarify whether an entity considers the onerous test before or after applying the practical expedient to consecutive increments of service in paragraph 30. If the Boards intend that an entity should consider the onerous test after applying the practical expedient in paragraph 30, then an additional question is whether the onerous test is optional. At present, paragraph 30 states that an entity “may” apply the practical expedient. This seems to leave open the possibility that an entity with an onerous performance obligation may use the practical expedient to pick and choose different performance obligations to combine with a view to avoiding recognition of an onerous obligation. We believe this outcome would be inappropriate, and understand it was not the intention of the Boards.

We appreciate that, taken together, the lack of specificity as to unit of account when performance obligations are satisfied over time and the optional practical expedient in paragraph 30 introduce significant flexibility for entities in applying the proposed revenue recognition model. However, we do not believe it is appropriate that entities should have a de facto choice as to the identification of onerous obligations.

**Significant Integration Services**

Paragraph 29 of the Revised Exposure Draft states that performance obligations are not distinct if (i) the goods or services in the bundle are highly interrelated and transferring them to the customer requires the entity to provide a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted and (ii) the bundle of goods or services is significantly modified or customised to fulfil the contract. The guidance applies to a significant service of integrating a “bundle” of goods or services. We agree with and understand the concept in the context of a construction contract with an implicit need for the entity to significantly integrate multiple phases or inputs in order to produce what the customer is purchasing. However, applying this concept to transactions outside the construction industry is less clear and could lead to unintended diversity in practice without further clarity.

For example, consider a software company that licenses its enterprise software to a customer and agrees to implement the software for the customer in the customer’s environment. While the implementation services do not typically involve significant customisation of the software code, the services are necessary and do entail modification or customisation to the various features of the software for utilisation by a particular customer and can only be performed by a trained service provider. The software vendor often sells its software to customers without the implementation services because other service providers can and do perform implementation services for its customers. In addition, the software vendor often sells implementation services separately in situations where the customer decides to implement the licensed software in another location.
In this example, the service and software are clearly distinct, but given the criteria in paragraph 29, without further clarification, some software vendors may conclude they are required to combine the software and implementation services into a single performance obligation. Furthermore, paragraph BC79 implies that an installation service that is other than “simple” could fall within the scope of paragraph 29. We believe the criteria in paragraph 28 are sufficient for evaluating whether the delivered item (i.e., the software in our example) is distinct from the installation and implementation services. Therefore, the Boards should revise the guidance in the final standard to clarify that implementation or installation services, such as those described above, even if significant or complex, do not represent a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted.

Performance Obligations Satisfied Over Time

We agree with the Boards’ efforts to develop guidance to assist entities to determine when control of a good or service transfers over time and, thus, when a performance obligation is satisfied over time. We believe that the proposed requirements represent a significant improvement over the proposals in the IASB Exposure Draft ED/2010/6 Revenue from Contracts with Customers and FASB Proposed Accounting Standards Update Revenue Recognition (Topic 605) – Revenue from Contracts with Customers (2010 Exposure Draft).

We understand that some of the requirements have been developed in order to clarify the application of the transfer of control concept to specific types of contracts (certain services and real estate). We believe the requirements result in appropriate accounting outcomes for the specific fact patterns the Boards had in mind. However, the Boards should clarify the requirements in paragraph 35(b) and link them more closely to the overall transfer of control concept. We believe that this would enhance the operationality of the final standard and improve the consistency with which entities determine which performance obligations are satisfied over time. The ongoing application issues for IFRS reporting entities arising from IFRIC 15 Agreements for the Construction of Real Estate highlight the challenges of implementing a ‘continuous transfer’ approach without clarity as to the underlying principle and how it is to be applied.

At present, we believe that the criteria in paragraph 35(b) do not specifically relate to how control of an asset is transferred to the customer in accordance with the guidance in paragraph 32. Rather, it appears that the Boards intend for the criteria in paragraph 35(b) to capture when transfer of ‘effective’ control of an asset to the customer occurs over time. We believe that the principle in paragraph 31 should be clarified to indicate that ‘effective’ control of an asset may be transferred to a customer over time in certain circumstances and that paragraph 35(b) should indicate that ‘effective’ control of an asset is transferred to the customer if the entity’s performance does not create an asset with alternative use to the entity and at least one of the additional criteria in that subparagraph are met. This will better align the criteria in paragraph 35(b) to the concept of transfer of control and reduce the risk that the proposed requirements in
paragraph 35(b) are extended or applied by analogy to other fact patterns that were not intended by the Boards.

We also suggest that the Boards consider further: (1) the guidance on identifying whether an asset has an alternative use; (2) the clarity of the proposed requirements in paragraph 35(b)(ii); and (3) the potential practical application issues arising from the proposed requirements in paragraph 35(b)(iii). We explain these specific points further in our response to Question 1 in Appendix A to this letter.

While we understand that the Boards have conducted outreach to some industries, we believe it is of great importance to ensure that the model is operational across a broad range of transactions and jurisdictions. We suggest the Boards conduct outreach in various jurisdictions and industries (e.g., real estate, contract manufacturers, software, and service providers) to specifically test the application of the proposed requirements in paragraph 35(b) against different fact patterns that may exist in different countries to ensure conclusions are consistent with the economics of the transactions.

Costs to Fulfil Performance Obligations Satisfied Over Time

As further discussed in our observations in Appendix B, we are concerned that the guidance in the Revised Exposure Draft may not be sufficient to promote consistent cost accounting, particularly in respect of performance obligations that are satisfied over time. Because the cost guidance currently contained in ASC Subtopic 605-35 Revenue Recognition—Construction-Type and Production-Type Contracts and IAS 11 Construction Contracts would be superseded and IAS 2 Inventories would be amended to delete all references to the inventories of service providers, the principal guidance on fulfilment costs for construction and service contracts will be three paragraphs in the Revised Exposure Draft. We recommend that the Boards address these concerns in the outreach efforts to investigate the consistency of interpretation of these paragraphs by entities currently applying ASC Subtopic 605-35 and IAS 11.

Although we agree that the final standard does not need to address all areas related to accounting for costs, we believe that the Boards should consider whether it is necessary to develop further guidance to fill any ‘gaps’ created by the withdrawal of existing standards.

Financial Services Transactions

In order to meet the Boards’ objective to develop a single revenue recognition standard that would apply to all revenue transactions across industries, we believe there should be more specific consideration of different types of transactions in the financial services industry. The Revised Exposure Draft includes an illustrative example of a transaction in the asset management industry; however, we believe the Boards should consider other transactions in the broader financial services industry such as how the proposal would be applied to depositor services (e.g., cheque processing or ATM services) and provide additional clarification on how these types of transactions would be accounted for under the Revised Exposure Draft.
An IFRS-specific example of the limited guidance for financial services transactions is included in the consequential amendments set out in paragraph D23 to IAS 39 Financial Instruments: Recognition and Measurement, specifically paragraph 47. Paragraph 47 sets out the requirements for accounting for financial guarantee contracts after initial recognition and includes a requirement in certain instances to record income from financial guarantee contracts in accordance with the Revised Exposure Draft. It may be helpful to include an illustrative example of a plain vanilla financial guarantee contract to illustrate how this requirement is intended to be applied.

If you have any questions about our comments or wish to discuss any of these matters further, please contact Mary Tokar, Brian O’Donovan or Philip Dowad with KPMG’s International Standards Group in London on +44 (0)20 7694 8871, or Mark Bielstein (+1 (212) 909-5419), Tamara Mathis (+1 (212) 909-5302) or Paul Munter (+1 (212) 909-5567) with KPMG LLP in New York.

Yours faithfully

KPMG IFRG Limited

KPMG IFRG Limited
Appendix A

KPMG’s Responses to Specific Questions Posed by the Boards

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?

As explained in the covering letter, we support the Boards’ efforts to develop guidance to assist entities to determine when control of a good or service transfers over time and, thus, when a performance obligation is satisfied over time. We believe that the proposed requirements represent a significant improvement over the proposals in the 2010 Exposure Draft. The Boards should clarify the requirements in paragraph 35(b) and link them more closely to the overall transfer of control concept, as discussed further below.

Guidance on identifying whether an asset has an alternative use

At present, paragraph 36 indicates that an asset would not have an alternative use to the entity if the contract has “substantive” terms that preclude the entity from directing the asset to another customer. The meaning of “substantive” should be clarified to indicate that there needs to be a substantive reason for the presence of a contractual restriction on transfer rather than simply the presence of an enforceable contractual restriction to conclude there is no alternative use to the entity. We are concerned that, in the absence of such a clarification, there could be a perception that changes to a contract to include non-substantive contractual terms could determine whether an arrangement qualifies for recognition of revenue over time. For example, a contract to sell a largely standardised good should not necessarily qualify for recognition over time simply because the contract is amended to include the serial number of the specific item being sold.

Clarity of the proposed requirements in paragraph 35(b)(ii)

We recommend that the Boards clarify the wording of paragraph 35(b)(ii) as it appears those provisions may cause confusion in practice. For example, it appears from outreach events that some constituents believe that a construction contract may qualify for recognition of revenue over time under paragraph 35(b)(ii) because an incoming contractor would not be required to repeat work performed by a previous contractor. We understand that the Boards’ intention is that paragraph 35(b)(ii) would apply to service contracts, e.g., contracts for transportation services, but would not apply to construction contracts. One possible approach would be to amend the first sentence of paragraph 35(b)(ii) to read “another entity would not need to substantially re-perform the work the entity has completed to date if the other entity was required to fulfil the remaining performance obligation to the customer, and did not have the benefit of any asset (e.g., work in progress) presently controlled by the entity.”
Potential practical application issues arising from the proposed requirements in paragraph 35(b)(iii)

We believe that the criteria in paragraph 35(b)(iii) (and the related illustrative example, Example 7) should be clarified further in the following areas.

- The reference in paragraph 35(b)(iii) to a right to payment, and the discussion in the Basis for Conclusions, suggests that a right to payment may exist irrespective of the actual pattern of payments by the buyer, i.e., it is the existence of the right that is the determining factor. However, Example 7 explains in some detail that the buyer arranges financing and makes progress payments, as if the existence of progress payments were the determining factor. If it is the Boards’ intention that it is the legal existence of the right that is the key, then we suggest that the illustrative example be reworked to illustrate this point.

- It is not clear how to apply the model to a single unit within a larger building. For example, consider a contract to purchase a unit on the top floor of a 30 floor building that is under construction. Ownership of the unit also conveys rights over the land on which the building stands. The land cost represents 40% of the total cost of the project and the entity has constructed the first 10 floors of the building, incurring 33% of the construction cost. For the purposes of applying paragraph 35(b)(iii) to the contract to sell the unit on the 30th floor, it is unclear whether the extent of performance to date is 60% (transfer of land interest plus one-third of building construction compared to total cost), 33% (one third of building construction cost), nil (construction on the 30th floor has not yet commenced), or some other figure.

**Question 2:** Paragraphs 68 and 69 state that an entity would apply Topic 310 (or IFRS 9, if applicable) to account for amounts of promised consideration that the entity assesses to be uncollectible 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?

We generally agree with the proposals. However, we believe the Boards should clarify (i) presentation of impairments of receivables due to a customer’s credit risk in profit or loss and (ii) the accounting for impairments of receivables when there is a significant financing component.

Specifically, we believe the Boards should clarify whether presentation of an impairment of a receivable in a separate line item “adjacent to revenue” means that the impairment expense is a component of net revenue or is simply a separate line item directly adjacent to the gross revenue line item. We believe the impairment should be reported as a component of net revenue and the Boards should clarify, particularly under IFRS, whether that net figure includes all revenues or only revenue from contracts with customers within the scope of the new standard. This
clarification should address presentation in the statement of comprehensive income and segmental disclosures.

Paragraph 69 of the Revised Exposure Draft indicates that impairments of contracts without a significant financing component are presented as a separate line item adjacent to the revenue. Paragraph BC175 of the Basis for Conclusions indicates that the presentation of any impairment losses from long-term trade receivables with a significant financing component would be consistent with the presentation of impairment losses for other types of financial assets. We believe having two separate presentations for impairments of receivables arising from contracts with customers is confusing. Accordingly, we believe that bifurcation of the presentation of impairment losses from receivables with a significant financing component between a line item “adjacent to revenue” and interest expense would be appropriate. If the Boards believe this bifurcation would be unduly burdensome, a practical expedient to classify all impairments of receivables from contracts with customers adjacent to revenue would be acceptable.

Additional comments on the interaction of the proposals with the requirements of IFRS 9 Financial Instruments are discussed in Appendix D.

**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?

Generally, we agree with the model as proposed. However, we believe the Boards should further clarify the interaction between the constraint on revenue in paragraph 81 and the allocation of contingent revenue entirely to a distinct good or service in paragraph 76. It is not clear from the Revised Exposure Draft that once an entity concludes that contingent consideration is allocated entirely to a distinct good or service, the contingent amounts are completely allocated to that distinct good or service and are not otherwise factored into the cumulative revenue constraint determination. We believe the Boards intended that the cumulative constraint be applied at the performance obligation level if an entity allocates contingent revenue to a single performance obligation under paragraph 76, and otherwise that it be applied at the contract level. If so, we recommend that the Boards state this in paragraph 81.

In addition, paragraph 85 of the Revised Exposure Draft indicates that if an entity licenses intellectual property to a customer and the customer promises to pay an additional amount of consideration that varies based on the customer’s subsequent sales of a good or service (e.g.,
sales-based royalty), then the entity is not reasonably assured to be entitled to the additional amount of consideration until the uncertainty is resolved. Paragraph BC203 explains why the Boards consider this approach appropriate in the case of intellectual property but does not explain why the Boards chose to introduce a separate requirement for such cases, rather than propose common requirements for all transactions including variable consideration based on the customer’s subsequent sales of a good or service.

If the Boards consider it appropriate to limit the guidance in paragraph 85 to licenses of a specific class of asset, intellectual property, then we believe the Boards should provide a more comprehensive list of examples of intellectual property in various industries (e.g., a drug candidate in the biotech or pharmaceutical industries). In addition, the Boards should consider including additional guidance on determining what constitutes licensing of intellectual property (see, e.g., the discussion at the 27 July 2011 FASB EITF Agenda Committee Meeting). For IFRS users, it will be important to clarify the distinction between a lease and a licence of intellectual property, given that IAS 17.2(b) excludes only some licensing agreements from the scope of IAS 17 Leases.

**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?

We continue to believe the onerous test should be performed at the contract level, rather than for each or certain performance obligations. However, except as discussed below, we understand the Boards’ process and considerations in arriving at the proposed model for this project, including different timing of recognition of an onerous loss if calculated at the contract level due to legacy differences in cost, liability and intangible asset guidance in U.S. GAAP and IFRS. We encourage the Boards to continue to address this issue and its related implications in a broader context with other future projects.

We believe the final standard should not include the arbitrary ‘bright-line’ exception for accounting for onerous liabilities for contracts satisfied for a period of time less than one year. It seems counterintuitive that a performance obligation that is expected to be satisfied over 51 weeks would be exempt from the requirement to recognise an onerous liability, whereas a performance obligation that is expected to be satisfied over 53 weeks is not. Removing this exception would increase the consistency of accounting for similar performance obligations. It would also reduce the pressure on the initial estimate of the time required to complete a performance obligation and eliminate the anomaly that a key factor that makes performance obligations onerous – that they take longer to satisfy than expected – is excluded from the analysis.

Additionally, removing this exception would help mitigate our concerns on the impact to the onerous test when determining the unit of account for multiple units of repetitive service in a
contract that collectively span a period of time greater than one year. Please see *Identifying Separate Performance Obligations* in our covering letter for a more detailed discussion of this issue.

We believe that the Boards should clarify the measurement basis of the lowest cost of settling a performance obligation. We support an approach in which the costs that relate directly to satisfying the performance obligation should be based upon the present value of the expected costs of satisfying that performance obligation, similar to the measurement of obligations under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. If the Boards prefer not to include comprehensive measurement guidance for onerous obligations in the revenue standard, then one possible approach under IFRS would be to exclude obligations under contracts with customers from the scope of IAS 37 for recognition purposes but not for measurement purposes. See Appendix D for further discussion.

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

1. **The disaggregation of revenue** (paragraphs 114–116)
2. **A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period** (paragraph 117)
3. **An analysis of the entity’s remaining performance obligations** (paragraphs 119–121)
4. **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)
5. **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 statements? 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 statements.

We generally agree with the disclosure objectives. However, the Boards should continue to obtain information on the needs of financial statement users and the costs to preparers when determining the disclosure requirements for contracts with customers for both annual and interim financial statements. In particular, the FASB should ensure that there is consistency in the approach taken between the Revised Exposure Draft and the FASB’s Disclosure Framework Project.

Given the extent of annual disclosures that would be required by the Revised Exposure Draft, we question whether such extensive interim period disclosures are necessary when there have
been no significant changes in principles, policies, practices, trends, or other information, consistent with the requirements of FASB Topic 270 *Interim Reporting* and IAS 34 *Interim Financial Reporting*.

**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 Topic 360, IAS 16, or IAS 40), the Boards propose amending other standards to require that an entity apply (a) the proposed guidance on control to determine when to derecognise the asset and (b) the proposed measurement guidance 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 guidance to account for the transfer of non-financial assets that are not an output of an entity’s ordinary activities? If not, what alternative do you recommend and why?

We agree that an entity should apply the proposed control and measurement guidance to account for the transfer of non-financial assets that are not an output of an entity’s ordinary activities.
Appendix B

Other Observations

Combination of Contracts

The Revised Exposure Draft indicates that an entity would not combine two or more contracts unless the contracts are “entered into at or near the same time with the same customer” and any one or more of three additional criteria is met. Thus, if contracts are not entered into at or near the same time, they would not be combined even if they are negotiated as a package with a single commercial objective. We believe the principle for determining whether to combine contracts should be based on the nature and objectives of the transaction as opposed to the timing of the execution of the contracts. Hence, we suggest that the final standard require contracts to be combined when they are negotiated as a package with a single commercial objective and provide factors that would indicate whether the contracts are negotiated as a package. We suggest that the remaining two criteria currently provided in paragraph 17 of the Revised Exposure Draft be retained as indicators and the third criterion should be “contracts entered into or negotiated at or near the same time with the same customer (or related parties).”

Portfolio of Contracts – Practical Expedient

Further with regard to combining of contracts, we read paragraph 17 of the Revised Exposure Draft as precluding the combining of contracts entered into with unrelated parties. Paragraph 6 of the Revised Exposure Draft provides a practical expedient that vendors may apply the guidance to a portfolio of contracts if the results of doing so would not differ materially from applying the requirements to individual contracts. Our reading of these two paragraphs would preclude the combining of contracts with unrelated parties to create a different unit of account from the individual customer contracts even when applying the practical expedient of paragraph 6 (i.e., the practical expedient does not change the unit of account to the portfolio). We believe it would be helpful if the Boards would make this point explicitly.

Contract Modifications

The guidance in paragraph 19 of the Revised Exposure Draft allows an entity to apply the proposed guidance to a contract modification if the parties to the contract have approved a change in the scope but have not yet determined the corresponding change in price as long as the entity has an “expectation that the price of the modification will be approved.” It is unclear how to determine when an entity has an “expectation that the price of a modification will be approved.” One possible approach would be to require that an entity apply the proposed guidance to a contract modification when the entity is “reasonably assured” the price will be approved. This would reduce the number of different thresholds that an entity is required to interpret in order to apply the model and would also help to align the treatment of unpriced contract modifications and variable consideration, both of which involve agreement as to the scope of a performance obligation but uncertainty as to its pricing.
Identifying Separate Performance Obligations – Implied/Constructive Performance Obligations

The Revised Exposure Draft states that the guidance for combining contracts would not be applied to contracts with different customers unless those customers are related parties (paragraph BC54 notes that related parties is used as defined in ASC Topic 850 Related Party Disclosures and IAS 24 Related Party Disclosures). Therefore, in most cases an entity would not combine contracts with different customers in the distribution channel because they are not related parties. For example, a software vendor sells software products to a reseller who then sells the software products to end users. The software vendor subsequently provides telephone support to the end user free of charge without the involvement of the reseller. Because the reseller and the end customer are not related parties, these contracts would not be combined under the proposed guidance. While the reseller is not entitled to receive any additional goods or services from the vendor, the reseller receives a benefit in marketing the goods or services as a result of the vendor's business practices, published statements or specific statements that create a valid expectation by the end customer that it will receive additional goods or services from the vendor.

We suggest that paragraph 24 of the final standard, which already states that performance obligations may be implied, be revised to clarify that promises to provide free or discounted goods or services to other parties in the distribution channel that purchase a vendor's goods or services from a customer may represent implied performance obligations in a contract with a customer (i.e., the reseller).

Identifying Separate Performance Obligations – Administrative Tasks

Paragraph 25 of the Revised Exposure Draft indicates that certain activities that an entity must undertake to fulfill a contract are not performance obligations unless the entity transfers a good or service to the customer as those activities occur. For example, a service provider may need to perform various administrative tasks to set up a contract. Because those setup activities do not transfer a good or service to the customer, they are not performance obligations.

The Boards’ inclusion of the notion that certain activities required to fulfill a contract are administrative tasks and not performance obligations appears to add an additional step to the process of identifying separate performance obligations. It is not clear whether the Boards’ intent with this guidance is to reiterate that activities that do not transfer goods or services are not distinct and, thus, not separate performance obligations, or to highlight that certain fulfillment activities themselves are not performance obligations and would not impact revenue recognition. For example, if a vendor is required to deliver a good to a customer and also physically deliver the product manual to the customer, assuming the good is distinct from the product manual, it is not clear whether the requirement to deliver the product manual should be evaluated to determine whether it is a separate performance obligation, a substantive part of the obligation to transfer the good, or an administrative task. If the requirement to deliver the product manual is considered an administrative task rather than a performance obligation, all the
Revenue under the contract would be recognised upon transfer of the product even if the product manual has not been delivered.

The Basis for Conclusions of the Revised Exposure Draft notes that the Boards decided not to exempt an entity from accounting for performance obligations that the entity might regard as inconsequential or perfunctory unless they are assessed as immaterial. While we would be supportive of a provision in the final standard that would allow a vendor not to consider certain inconsequential or perfunctory activities as performance obligations, without further clarity as to what is meant by an administrative task, it will be difficult to distinguish fulfilment activities that are performance obligations from those activities that are administrative tasks. We suggest that the Boards clarify what is meant by an administrative task and consider additional illustrative examples of administrative tasks that would be distinguished from performance obligations.

Risks and Rewards of Ownership

Paragraph 37(d) of the Revised Exposure Draft provides “the customer has the significant risks and rewards of ownership” as an indicator of transfer of control. Under most extant standards based on the “risks and rewards” concept, the extent of transfer of risks and rewards functions as a two-way indicator, i.e., transfer of risks and rewards indicates that an item has been transferred whereas retention of risks and rewards indicates that an item has not been transferred.

However, as illustrated in Example 6, the additional performance obligation for risk coverage does not affect when the customer obtains control of the product, but rather is considered a separate performance obligation in the contract. Given the wording of paragraph 37(d) and the conclusion in Example 6, it is unclear when the lack of transfer of the significant risks and rewards of ownership to the customer would preclude revenue recognition for a product versus determining that retained risks are separate performance obligations, particularly when the separate performance obligation results in the retention of risk with respect to the product.

Risk and rewards of ownership is a different concept from control and inclusion of this indicator creates confusion as to whether the Boards’ fundamental principle is transfer of control or some hybrid model. We recommend that the Boards consider further how “risk and rewards of ownership” is intended to function as an indicator of transfer of control and whether inclusion of this indicator clarifies or confuses how the transfer of control principle is to be applied.

Uninstalled Materials

The Revised Exposure Draft indicates that when applying an input method to a separate performance obligation that includes goods that the customer obtains control of significantly before receiving services related to those goods, the “best depiction” of the entity’s performance may be for the entity to recognize revenue for the transferred goods in an amount equal to the cost of those goods if both of the two criteria in paragraph 46 are met. It is unclear what
alternative method(s) might better depict an entity’s performance if the criteria in paragraph 46 are met. We note that paragraph BC122 indicates that the Boards decided that an entity should recognise revenue to the extent of costs when the specified criteria are met, which is inconsistent with the guidance in paragraph 46 of the Revised Exposure Draft. We suggest the Boards clarify whether an entity is required to recognise revenue to the extent of costs if the criteria are met or, if there are alternative methods that may better depict an entity’s performance, provide additional clarification or illustrative examples in the final standard of the alternative methods that might be appropriate to account for these unpacked materials.

**Variable Consideration**

When estimating the transaction price, it is unclear why an entity must apply only one method (i.e., either the expected value or the most likely amount) consistently throughout the contract, as specified in paragraph 56 of the Revised Exposure Draft. If the facts and circumstances change during the contract such that the alternative method would better predict the amount of consideration to which the entity will be entitled, then we believe it would be appropriate to use the alternative approach. Additionally, we believe it may be appropriate to apply alternative methods to variably priced performance obligations within the same contract in determining the contract’s transaction price. We recommend the final standard be revised to allow for consideration of either method to estimate the transaction price over the life of the contract and for its component parts if facts and circumstances indicate that the alternative method would better predict the amount of consideration to which an entity will be entitled. Accordingly, a change in approach would be considered a change in estimate, as opposed to a change in accounting policy.

**The Time Value of Money**

We continue to believe that the guidance related to time value of money, as drafted in the Revised Exposure Draft, may be complex and costly to implement, particularly for long-term or multiple-element arrangements in which goods or services are transferred at various points in time and cash payments are made throughout the contract term. If additional elements are present in the contract, such as variable consideration, then the calculations become even more complex. In light of this complexity, we believe the Boards should provide additional examples to illustrate how to apply the time value of money in more complex arrangements. As we have previously communicated in our comment letter on the 2010 Exposure Draft, we continue to question whether it is appropriate to accrete interest on a liability to perform (i.e., a non-financial liability) when payment is made by the customer before revenue is recognised and the related resources in progress (purchased materials, labour, etc.) are not also adjusted for the time value of money.

**Distinct Goods or Services – Slotting Fees**

We believe the final standard should include an illustrative example for the accounting for payments to a customer for product placement services (i.e., slotting fees) as either a distinct
service or as reduction of the transaction price based on the guidance in paragraph 66 of the Revised Exposure Draft.

Example 23 in the 2010 Exposure Draft contained an illustration stating that consideration payable to a customer for product placement would represent the purchase of a distinct service and therefore would be accounted for as an expense rather than a reduction of the transaction price, which would be a significant change from the current U.S. GAAP guidance in ASC Subtopic 605-50 Revenue—Customer Payments and Incentives. While Example 23 in the 2010 Exposure Draft did not articulate why the product placement service is distinct, we presume that the conclusion was based on a vendor having the option or ability to purchase display space for its products from third parties in an attempt to sell those products. However, in the case of slotting fees, the vendor pays the reseller to display products that are owned by the reseller, not the vendor. The reason a slotting transaction occurs is to facilitate the reseller's sale of those products to generate more sales of the vendor's products.

Many respondents to the 2010 Exposure Draft, including KPMG, did not agree with the conclusion in Example 23 that a product placement service represents a distinct service. Because the Boards removed the illustrative example in the Revised Exposure Draft, it is unclear whether the Boards agreed with the respondents to the 2010 Exposure Draft that a product placement service is not a distinct service or otherwise. Without additional guidance in the final standard, diversity in practice may occur.

Allocating the Transaction Price to Separate Performance Obligations – Use of Residual Approach

The Revised Exposure Draft indicates that the residual approach may be used to estimate the selling price when the selling price for a good or service is uncertain or highly variable. It further notes that a selling price is uncertain when an entity has not yet established a price for a good or service and the good or service has not previously been sold. Based on this definition of uncertain, it appears that any good or service that is not sold on a standalone basis could qualify for the residual approach if an entity simply does not make an effort to establish a price for that good or service. We understand that it was not the Boards' intent to allow for the use of the residual method if other suitable estimation methods could be used in determining the estimated stand alone selling price. Therefore, we believe the Boards should clarify how widely they intended for the residual method to be available for application.

Costs to Fulfil a Contract

Recognition of Costs to Fulfil Performance Obligations Satisfied Over Time

We are concerned that the guidance in the Revised Exposure Draft may not be sufficient to promote consistent cost accounting, particularly in respect of performance obligations that are satisfied over time. Because the cost guidance currently contained in ASC Subtopic 605-35 and IAS 11 would be superseded and IAS 2 would be amended to delete all references to the
inventories of service providers, the principal guidance on fulfilment costs for construction and service contracts will be three paragraphs in the Revised Exposure Draft. We recommend that the Boards address these concerns in their outreach efforts to investigate the consistency of interpretation of these paragraphs by entities currently applying ASC Subtopic 605-35 and IAS 11.

As an example, paragraph 91 indicates that costs incurred in fulfilling a contract that are in the scope of another Topic or IFRS are to be accounted for in accordance with that other Topic or IFRS. Paragraph 93 of the Revised Exposure Draft provides a list of costs of fulfilling a contract that should be expensed as incurred including in paragraph 91(c) costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract. However, it is unclear how this guidance applies to the material costs related to a single performance obligation to construct or manufacture an asset that is satisfied over time.

To further illustrate, a manufacturer of large customised machinery incurs material costs, including specialised component equipment, of CU30 million and labour costs of CU20 million to satisfy over time a single performance obligation to construct specialised machinery for a fixed transaction price of CU60 million. The materials and components are sourced from third party suppliers at the outset of the contract. Control of the materials and components are not individually transferred to the customer as the construction occurs. The manufacturer has determined that the best measure of progress toward complete satisfaction of the performance obligation is labour hours. At period end, the manufacturer has incurred 50% of the expected labour hours and costs and all CU30 million of materials and components have been consumed into the manufacturing process. Accordingly, the manufacturer would recognise revenue of CU30 million and labour costs of CU10 million. However, it is unclear whether any, a portion, or all of the material costs would be recognised in earnings at period end.

ASC Topic 330 Inventory and IAS 2 (as amended by the Revised Exposure Draft) would include within their scope assets in the process of production for sale in the ordinary course of business and assets that are to be currently consumed in the production of goods or services to be available for sale. Some may interpret ASC Topic 330 and IAS 2 to indicate that none of the materials and component costs should be recognised in earnings until control has been transferred to the customer, because those costs are within another Topic or IFRS. In that case, none of the material costs would be expensed until completion and transfer of the constructed asset. Others may interpret paragraph 91(c) to indicate that the materials and component costs should be expensed as incurred, presumably when consumed in the manufacturing process, because those costs relate to a partially satisfied performance obligation. We believe the Boards should clarify when material costs related to a single performance obligation to construct or manufacture an asset that is satisfied over time are recognised as an expense to avoid unintended diversity.
Depending on the approach, the profit margins recognised for a single performance obligation could differ drastically from period to period. Although we agree that the final standard does not need to address all areas related to accounting for costs, we believe that the Boards should consider whether it is necessary to develop further guidance to fill any ‘gaps’ created by the withdrawal of existing standards.

Contracts to Design and Construct Multiple Units

Paragraph BC232 indicates that if a vendor has a single performance obligation to deliver a specified number of units that is satisfied over time and the cost to produce each unit is expected to decline as more units are produced, then the vendor likely would select a method (e.g., cost-to-cost) that would result in the entity recognising more revenue and expense for the earlier units produced relative to the later units. Paragraph BC233 indicates that if the promise to transfer a specified number of units in a contract that does not give rise to a single performance obligation that is satisfied over time, the costs associated with each unit would be in the scope of other standards (e.g., inventory) and expensed as each unit is delivered. As a result, the determination of whether or not a contract to deliver a specified number of units contains a single performance obligation could have a significant impact on the profit margins recognised by a vendor from period to period. Therefore, we believe the final standard should contain guidance or illustrations of the factors a vendor would consider when drawing this conclusion. For example, if the contract requires the vendor to provide a significant service to engineer and design the units in addition to manufacturing the units, then that would indicate that the contract contains a single performance obligation.

Impairment of Costs to Fulfil or Obtain a Contract

The Revised Exposure Draft requires that an entity recognise an asset for certain fulfilment costs and incremental costs of obtaining a contract. The guidance in paragraphs 100 and 101 indicates that an entity would recognise an impairment loss for such assets if the carrying amount of the asset exceeds the remaining amount of consideration to which an entity “expects to be entitled,” which is the transaction price. Thus, the impairment test for these assets would not be based on expected cash flows as it does not incorporate an assessment of collectibility.

To illustrate, assume a contract to provide services has a remaining transaction price of CU2,000, which exceeds the carrying amount of the asset of CU500. Subsequent to contract inception, a determination is made that the entity does not expect to collect any of the remaining transaction price due to credit issues encountered by the customer. However, the corresponding asset of CU500 resulting from the cost guidance in the Revised Exposure Draft would not be impaired because the remaining transaction price, which does not incorporate credit risk, exceeds the carrying amount of the asset. Given that this asset will have no future economic benefit, it is unclear how the capitalised costs in this example would meet the definition of an asset in the IFRS Conceptual Framework and FASB Concepts Statement No. 6 Elements of Financial Statements.
We believe the impairment test for these assets should be revised in the final standard to incorporate the concept of collectibility.

**Customer Options for Additional Goods and Services**

Paragraph IG21/B21 of the Revised Exposure Draft states that “a contract with more than one performance obligation” that also grants an option to acquire additional goods or services may give rise to a separate performance obligation. It is unclear why this guidance would not apply to a contract with only one performance obligation and an option to acquire additional goods and services that also may give rise to an additional performance obligation. The final standard should be revised to indicate that the guidance on evaluating customer options to acquire additional goods and services would apply to all contracts in the scope of the standard that include a customer option to acquire additional goods and services.

**Repurchase Agreements**

By focusing only on unconditional repurchase agreements (i.e., forward, call option, or put option), the Revised Exposure Draft appears to create a category of instruments based solely upon conditionality. We believe the final standard should be revised to delete the words “unconditional” from the description of the forms of repurchase agreements that are provided in paragraph IG39. If such a change were not made, then we believe that it would be possible to create arrangements that are economically similar to unconditional forward contracts; however, substantially different accounting would result. For example, a seller of real estate could retain an option to repurchase the property from the buyer and the buyer could have an option to require the seller to repurchase the property, both conditioned upon the property appreciating above a specified amount (which could be nominally greater than the original sales price). Notwithstanding, the likelihood of the property appreciating above the specific threshold, the conditionality of the options would appear to permit the seller to recognise revenue.

In addition, the Boards should include the guidance from paragraph BC320 that would indicate that conditional call options to repurchase an asset that are in effect protective rights (e.g., those that are common in the sale of perishable products and in the pharmaceutical industry) would not prohibit the recognition of revenue. Rather they would be accounted for as a sale with a right of return. This would be consistent with the guidance noted in ASC paragraph 360-20-40-39 Property, Plant, and Equipment—Real Estate Sales—Derecognition.

**Bill-and-hold Arrangements**

The Revised Exposure Draft removed the criterion that “the customer must have requested the contract to be on a bill-and-hold basis” and replaced that criterion with a requirement that “the reason for the bill-and-hold arrangement must be substantive.” If this change is retained in the final standard, we believe it should clearly state what the Boards intend by a substantive reason for the bill-and-hold arrangement and, in particular, whether there could be a substantive reason for a bill-and-hold arrangement that is not at the request of the customer. Without further clarity,
we believe that significant diversity in interpretation could arise among preparers, auditors and regulators leading to unintended diversity in practice or other unintended consequences.

**Allocation of Fixed Consideration When Variable Consideration Is Allocated to a Single Performance Obligation**

It is unclear how the model is applied when a portion of fixed consideration is allocated to a performance obligation to which contingent payments are allocated in their entirety. We believe it would be helpful if the Boards added a third scenario to Example 12—*Multiple performance obligations and contingent consideration* to demonstrate the application of the model to this kind of fact pattern. For example, the facts in scenario 1 could be modified such that the estimated standalone selling price of Licencees A and B are $500 and $1,300, respectively. In this fact pattern, we believe it is clear that allocating the variable fee entirely to Licence B would be consistent with the allocation principle in paragraph 70 when considering the other payment terms and performance obligations in the contract. Additionally, it appears that some portion of the fixed fee also would be allocated to Licence B. The Boards could use a scenario like this to set forth the factors that entities should consider when making this allocation.

We have also commented on the cumulative constraint on variable consideration in Question #3 in Appendix A.

**Relationship with Other Standards Projects**

The Boards’ latest work plans suggest that the projects on financial instruments, insurance, leases and revenue recognition may conclude at different times. As stated in our comment letter on the Boards’ Request for Views/Discussion Paper *Effective Dates and Transition Methods*, we believe that the Boards should limit the number of possible combinations of effective dates for standards by “batching” the effective dates of new and revised standards.

While we acknowledge that the Boards have not yet decided on the effective date of the Revised Exposure Draft, we believe that the effective date of the final standard on revenue should coincide with the effective date of the final standard for leases in order to align changes in lessor accounting with changes in revenue recognition.

In addition, the Boards should monitor the consistency of the emerging requirements across projects. If different conclusions are reached at the standards level, then the Boards should assess whether this will itself create additional application issues. To take a simple example, the Boards have reached different tentative conclusions on the treatment of the costs of obtaining a contract on each of the financial instruments, insurance, leases and revenue recognition projects. If the Boards are satisfied that this is appropriate, then they should also consider how to treat the costs of obtaining a contract that will be required to be separated and accounted for under two or more standards.
Basis for Conclusions

The Basis for Conclusions includes several concepts that we believe are of the level of importance to be included in the body of the final standard. This is important under both IFRS and U.S. GAAP, because the Basis for Conclusions is non-authoritative in both accounting frameworks. However, it is of particular importance in U.S. GAAP given that guidance in the Basis for Conclusions is not included in the FASB Accounting Standards Codification™. Specifically, we believe the following guidance should be included in the body of the final standard:

- BC34(b) – “If there is significant doubt at contract inception about the collectibility of consideration from the customer, that doubt may indicate that the parties are not committed to perform their respective obligations under the contract and thus the criterion in paragraph 14(b) may not be met.”

- BC73(a) – Clarification regarding the distinct criteria in paragraph 28(b) “...the good or service is an asset that, on its own, can be used, consumed, sold for an amount other than a scrap value, held, or otherwise used in a way that generates economic benefits.”

- BC91 – “The concept of control is similar to the basis for percentage-of-completion accounting in accordance with AICPA Statement of Position 81-1,” including the language extracted from Statement of Position 81-1 included in that paragraph.

- BC101 and BC102 – The Boards’ clarification of what is meant by “right to payment” in paragraph BC101 and illustrative guidance in paragraph BC102.

- BC119 - The Boards’ clarification of another appropriate output method under which revenue would be recognised at the amount of consideration to which the entity has a right to invoice.

- BC123 – “In cases in which an entity cannot reasonably measure its progress but the entity expects to recover the costs incurred in satisfying the performance obligation…the Boards decided that an entity should recognise revenue for the satisfaction of the performance obligation only to the extent of the costs incurred.”

- BC144 – The guidance in this paragraph related to prepaid phone cards and customer loyalty points and why they do not contain a significant financing component.

- BC147– The guidance included in the last three sentences of this paragraph that indicates that the time value of money may not be significant in instances in which a customer retains or withholds consideration to provide the customer with assurance that the entity will satisfactorily complete their obligations under the contract.
• BC155 – “The Boards noted that an entity would re-evaluate the effects of the time value of money when there is a change in the estimated timing of the transfer of goods or services to the customer.”

• BC220 – “If the other standards preclude the recognition of any asset arising from a particular cost, an asset cannot then be recognised under the proposed guidance.”

• BC232 and BC233 – The guidance regarding recognising revenue using the cost-to-cost method when the vendor has significant learning curve costs should be included in the body of the final standard. We also believe the Boards should further clarify when an entity would conclude that a contract to deliver multiple units is a single performance obligation. We would typically expect that each unit in these arrangements would be distinct and, thus, not a single performance obligation.

• BC300 – “A renewal option gives a customer the right to acquire additional goods or services of the same type as those supplied under an existing contract. This type of option could be described as … a cancellation option within a longer contract (e.g., a three-year contract that allows the customer to discontinue the contract at the end of each year).”

• BC320 – If the Boards do not modify the guidance on repurchase agreements as we have suggested in our separate comment above, then the following guidance should be included in the final standard. “If the entity has a conditional right to repurchase an asset, then the customer would obtain control of the asset and, therefore, revenue would be recognised subject to any sales return liability.”
Appendix C

Comments on the Amendments to the FASB Accounting Standards Codification™

Question A1: Do you agree that the proposed amendments that codify the guidance in the proposed Update on revenue recognition have been codified correctly? If not, what alternative amendment(s) do you recommend and why?

We generally agree that the proposed amendments that would codify the guidance in the Revised Exposure Draft have been codified correctly, except as follows.

ASC Subtopic 340-10: Other Assets and Deferred Costs—Overall

We believe the FASB should reconsider whether some or all of the guidance in ASC Section 340-10-25 and the related implementation guidance and illustrations in ASC Section 340-10-55 related to the design and development costs for moulds, dies, and other tools when such tools are produced but not owned by the supplier should be superseded by the final standard. We believe that the Revised Exposure Draft would provide an appropriate model for accounting for these costs. For example, a supplier may conclude that the tools produced to facilitate a supply contract but not owned by the supplier are distinct, in which case the Revised Exposure Draft would provide the accounting for these costs. In cases where the tools produced to facilitate a supply contract are not distinct, the costs related to these tools are akin to any other fulfilment cost incurred in a contract with a customer. Hence, it is unclear why these costs would not be within the scope of the cost guidance in the Revised Exposure Draft. As there currently is not any similar guidance in IFRS, maintaining the existing U.S. GAAP guidance could result in differences in practice between U.S. GAAP and IFRS preparers.

Question A2: Do you agree that the proposed consequential amendments that would result from the proposals in the proposed Update on revenue recognition have been appropriately reflected? If not, what alternative amendment(s) do you recommend and why?

We generally agree that the proposed consequential amendments that would result from the proposals in the Revised Exposure Draft are appropriately reflected, except as follows.

ASC Subtopic 985-20: Software—Costs of Software to be Sold, Leased or Otherwise Marketed

The proposed amendments to ASC paragraph 985-20-15-3(a) would delete the words “or for others under a contractual arrangement (see Subtopic 605-35)” from ASC paragraph 985-20-15-3(a), which implies that costs to develop software for others under a contractual arrangement would no longer be excluded from the scope of ASC Subtopic 985-20. However, ASC paragraph 985-10-15-3(b) would retain the guidance that indicates that ASC Subtopic 985-20 does not apply to software developed for others under a contractual arrangement, which is inconsistent with the amendments to ASC paragraph 985-20-15-3(a). If the FASB intends that costs to develop, modify or customise software under a contract with a customer within the
scope of ASC Subtopic 985-20 be included in the scope of the revenue topic as the amendments to ASC paragraph 985-20-15-3(a) would indicate, we question whether that cost guidance would be an appropriate model to apply to costs to develop, modify or customise software under a contract with a customer. Those costs currently are accounted for as contract costs under ASC Subtopic 605-35, using the same model that applies to costs incurred under construction-type and production-type contracts. Accordingly, we believe it would be more appropriate to account for those costs under the proposed guidance on contract fulfilment costs in the Revised Exposure Draft. Therefore, we believe those costs should continue to be excluded from the scope of ASC Subtopic 985-20.
Appendix D

Comments on Amendments to other IFRSs

Status of Illustrative Examples

The status of the Illustrative Examples is unclear in the IFRS version of the Revised Exposure Draft. The header to the Illustrative Examples states that they “accompany, but are not part of, the [draft] IFRS.” However, E1 states that “the following examples are an integral part of the [draft] IFRS.” The status should be clarified.

IAS 1 Presentation of Financial Statements

Paragraph 69 of the Revised Exposure Draft requires impairment losses to be presented in the statement of comprehensive income adjacent to the revenue line item. We suggest the IASB consider whether IAS 1.82 requires amendment to reflect this requirement.

IAS 2 Inventories

Paragraph BC210 states that IAS 2.31 may be relevant when considering arrangements that are satisfied at a point in time and so are outside the scope of the proposals on onerous obligations. Currently the last two sentences of paragraph 31 of IAS 2 read as follows: “Provisions may arise from firm sales contracts in excess of inventory quantities held or from firm purchase contracts. Such provisions are dealt with under IAS 37 Provisions, Contingent Liabilities and Contingent Assets.” We think this wording requires amendment, as contracts with customers (sales contracts) will be outside the scope of IAS 37 when the requirements of the Revised Exposure Draft become applicable and therefore the part of this guidance related to sales contracts would become redundant.

A related question is whether some contracts have been taken out of the scope of onerous contracts considerations inadvertently. For example, suppose a performance obligation is settled at a point in time and the inventory is not yet on hand, e.g., if the cost of steel rises for an entity that has promised to deliver 1000 shipping containers over the next 5 years for a fixed price. In this case, the contract with the customer would not be within the scope of the onerous test as it is satisfied at a point in time. Instead, the timing of the recognition of the expected loss appears to depend on when the entity acquires inventory, which is not related to the date the entity commits to or fulfills the contract.

In addition, we suggest that the IASB consider whether further amendment to IAS 2 is necessary to address the recognition and measurement of inventory that is sold subject to a right of return, as discussed in paragraphs B2-B9. Areas to consider include when inventory is recognised as an expense (IAS 2.34) and the cost base of inventory returned by customers.
IAS 37 Provisions, Contingent Liabilities and Contingent Assets

The Revised Exposure Draft scopes rights and obligations arising from contracts with customers out of IAS 37. As noted in our response to Question 4, we understand why the Boards have chosen to limit the scope of the onerous test in the Revised Exposure Draft. However, we are concerned that the Revised Exposure Draft contains significantly less guidance on measurement of onerous obligations than IAS 37. It is not clear whether the IASB intends entities to apply the measurement guidance in IAS 37 to onerous obligations identified under the Revised Exposure Draft by virtue of the hierarchy in IAS 8.11.

One possible approach here would be to expand the measurement guidance in the Revised Exposure Draft. This would increase consistency in the measurement of onerous obligations arising from contracts with customers between IFRS and U.S. GAAP; however, it may result in inconsistency in the measurement of obligations arising from contracts with customers and other legal and constructive obligations. An alternative approach would be to amend the proposed scope exclusion, such that onerous obligations were outside the scope of IAS 37 for recognition but not for measurement purposes. This would increase the consistency with which onerous obligations are measured under IFRS but could perpetuate differences between IFRS and U.S. GAAP.

IFRS 9 Financial Instruments

Paragraphs 58-60 discuss when an entity should discount the transaction price and include a practical expedient not to discount if the period between payment and the transfer of goods is one year or less. Separately, we also understand that the IASB plans to amend IFRS 13 Fair Value Measurement to clarify that the Board did not intend to change existing practice under IFRS under which entities measure short-term receivables with no stated interest rate at invoice amount if the discounting is not material.

We would prefer the IASB to align the practical expedient in the Revised Exposure Draft and in the financial instruments guidance, so that there is a common threshold for when entities are permitted not to discount short-term receivables arising from contracts with customers. If the IASB concludes that it is not appropriate to introduce a common threshold in the two standards, then we recommend that the Revised Exposure Draft clarify that its requirements take precedence on initial recognition.

IFRIC 18 Transfers of Assets from Customers

The Basis of Conclusions does not explain why the IASB chose to withdraw rather than amend IFRIC 18. Application issues may arise in respect of the fact patterns discussed in IFRIC 18, particularly if the effective dates of the Revenue and Leases standards are different.