Dear Sir

Exposure draft ED/2011/06: Revenue from Contracts with Customers

We appreciate the decision to engage in a second comment period for the revenue recognition project, and commend the Boards for continuing to enhance the model as a result of constituent feedback. Following consultation, this letter represents the views of the BDO network.¹

Performance obligations satisfied over time

Our principal observations, and most significant concerns, about the proposals in the exposure draft (ED) relate to performance obligations satisfied over time. If an entity’s performance does not create an asset with an alternative use, the ED allows the reporting entity to recognise revenue over time if another entity would not need to substantially reperform the work completed to date. Alternatively, revenue is recognised if the entity has a right to payment for performance completed to date and expects to fulfil the contract as promised. There is no clear linkage between these concepts. Further it is not apparent how control of an asset operates in the context of a service.

As such, we are concerned that the proposals for performance obligations satisfied over time, and the associated ability of an entity to recognise revenue as contract activity progresses, lack a clearly articulated principle. While we acknowledge that the circumstances of certain industry sectors in some jurisdictions may have contributed to this, we do not believe that it is appropriate. We also believe that the threshold for an entity to be permitted to recognise revenue as contract activity progresses has been set at too low a level. We have included suggestions in our detailed comments for how the requirements might be strengthened, including modifying the criteria under which an asset is considered to have alternative use to an entity.

For contracts involving the supply of services to qualify for revenue recognition as contract activity proceeds, we recommend strengthening the proposals by requiring a right to payment for activities completed to date in all circumstances. This unconditional obligation for the customer to pay, even if the vendor fails to complete the remainder of the contract, could function as a proxy for a customer acceptance’s that it has benefited from the services provided to date.
From a wider perspective, the lack of linkage to a clear principle may also lead to diversity in practice, and there are aspects of paragraphs 35 and 36 that are not entirely clear. Consequently, we encourage the Boards to revisit the proposals in paragraphs 35 and 36 as drafted, to ensure both their clarity and their linkage to the principle of control.

Onerous contracts

Contracts with a duration of less than 12 months would be excluded from an assessment of whether they are onerous. We believe this provision is inappropriate as an entity might have a series of contracts which are onerous and have durations of less than 12 months; these might also span a financial year end. In some cases, the exclusion of those contracts could result in financial statements being misleading.

We also disagree with the proposal to apply the onerous contract test at performance obligation level, with no consideration of whether two or more performance obligations are in fact linked resulting in an overall profitable contract obligation. We encourage the Boards to reconsider this decision.

We have responded to the ED’s detailed questions in the appendix, and have also provided additional thoughts to assist with implementation. As adjusted for these comments, we believe the proposed standard will be reasonably positioned to achieve its primary objectives.

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We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact Andrew Buchanan, our Global Head of IFRS, at +44 (0)20 7893 3300 or Lee Graul, the National Director of Accounting for BDO USA at (312) 616-4667.

Yours faithfully,

Andrew Buchanan

Global Head of IFRS
Appendix

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?

We agree with the principle that revenue should be recognised over time as an entity satisfies each performance obligation. However, we have concerns that the recognition guidance in paragraph 35 is not clearly linked to the notion of control as described in paragraph 32.

If an entity’s performance does not create an asset with an alternative use, paragraphs 35b(ii) and 35b(iii) allow an entity to recognise revenue over time if another entity would not need to substantially reperform the work completed to date, or if the entity has a right to payment for performance completed to date and expects to fulfill the contract as promised. There is no clear linkage between these concepts and paragraph 32 as to how control of an asset (even a ‘momentary’ asset) operates in the context of a service. Rather, the guidance in paragraphs 35b(ii) and (iii) appear to be exceptions to the general principle.

We also find paragraph 35b(ii) difficult to understand. Say an entity was constructing a property which did not have an alternative use, nor did a right to payment arise for work performed to date. In this case, the arrangement does not meet 35b(i) as it’s not a service, nor does it satisfy 35b(iii) since a right to payment does not exist as contract activity proceeds. This means that it is necessary to look at 35b(ii). In order to clarify its intent, we suggest elevating guidance currently reflected in BC98, as follows:

‘Another entity would not need to substantially reperform the work the entity has completed to date if that other entity were to fulfill the remaining obligation to the customer. In evaluating this criterion, the entity shall presume that another entity fulfilling the remainder of the contract would only not have the benefit of any asset (for example, work in process) presently controlled by the customer entity. Assets still controlled by the reporting entity should be disregarded. In addition, an entity shall disregard potential limitations (contractual or practical) that would prevent it from transferring a remaining performance obligation to another entity.’

We believe the underlying principle is based upon whether control of the asset has passed to the customer, and that it should be more prominently reflected in the text.

While we agree with the direction of paragraph 35, the lack of a clear principle may lead to diversity in practice. We recommend clarifying the relationship between paragraphs 35b(iii) with the principle in paragraph 32, and that the guidance is enhanced in order to make an appropriate distinction between a contract for services (where the ‘asset’ is consumed as services are delivered) and a contract for the construction of an asset.

For contracts involving the provision of services this could be accomplished, in part, by requiring a right to payment from a customer in all circumstances as a precondition for the vendor to be capable of recognising revenue for services performed to date. This would need to apply even if the vendor fails to complete the remainder of the contract. An unconditional payment obligation could, for contracts that involve the provision of services, function as a proxy for customer acceptance of the services received to date.
For contracts that involve the construction of an asset, the analysis is slightly different. This is because, although an asset might be in the process of being constructed, that does not necessarily mean that it is being transferred to the customer as construction progresses. We note that Example 7 describes a contractor that receives a ‘non refundable’ deposit at inception that nonetheless can be refunded to the customer if a completed unit is not ultimately delivered. This indicates that, during the construction phase, the customer may not be fully exposed to ownership risk of the partially completed property as, in the event of non delivery, the customer will be entitled to a refund. This leads to questions about whether the partially completed asset has genuinely been transferred to the customer.

Linked to this point, and consistent with the Alternative View set out in paragraphs AV6 and AV7, for contracts that involve the construction of an asset (typically a physical asset, although this could also apply to an intangible asset, such as a piece of software), we believe that too much weight is given to the question of whether a customer is required to pay as work is carried out, in determining whether revenue should be recognised over time or on completion of an asset. We do not believe that the timing of an entitlement to cash payments (or the actual payment of cash) is, in itself, such a significant factor. Instead, the focus should be on whether the asset under construction has been transferred to the customer. We believe that in order for recognition of revenue over time to be contemplated at all, in the event of default by a contractor before the construction of an asset has been completed, the customer must be required to take possession of that partially completed asset. The ability of the customer then immediately to put the partially completed asset back to the constructor in return for a cash refund should not be precluded. However, if the customer does have the ability to put the partially complete asset back to the contractor, the customer should not rank ahead of other unsecured creditors. Our suggested approach is consistent with the principle that the customer, and not the contractor, must control the asset during its construction in order to recognise revenue.

In addition, the text in paragraph 35b does not clearly address contracts involving the provision of services. We suggest that the text could be improved by stating ‘the entity’s performance creates an asset (whether from the provision of goods or services) which does not have an alternative use to the entity.’

Paragraph 35(b) (iii) contemplates recognition of revenue only where an entity has the right to payment for performance completed to date. However, a contract to deliver a container (either by sea or by road) might only include a total fixed fee. It would appear that this type of contract would fail the criteria for recognition of revenue as the transportation of the container is carried out, unless the contract contained a specific penalty clause that, in the event of termination prior to delivery to the ultimate destination, the entity is entitled to a proportion of the fixed fee. It would be helpful for this point to be clarified.

We disagree with the proposals at paragraph 36, as we believe that this sets the threshold for an asset not to have an alternative use to an entity at a level which is too low. Consider an entity which constructs 100 largely identical properties for sale (the basic structure of all the properties is the same, with the only differences being cosmetic such as slightly different kitchens and bathrooms). For that entity, if a particular customer decides to withdraw from its purchase of a particular property, the vendor will relatively easily be able to redirect that property to another customer. In those circumstances, we do not believe it is appropriate to take the view that the property does not have an alternative use. Of course, a particular customer may have entered into an exclusive contract, but a breach of that contract is of
little significant concern to the vendor due to the relative ease of finding an alternative purchaser in the event of default. In comparison, a property (for example, a specialised factory or a bespoke residential property) which is constructed to a customer’s specific design and detailed requirements may not readily be capable of being redirected to another customer, and in that case we would agree that the asset being constructed would not appear to have an alternative use to the vendor entity. We suggest that paragraph 36 could be redrafted to read (deleted text struck through and new text in bold):

‘When evaluating whether an asset has an alternative use to an entity, an entity shall consider at contract inception the effects of contractual and practical limitations on the entity’s ability to readily direct the promised asset to another customer. An asset may be of a standard design (such as a property with a standard basic structure and a choice of interior finishes) rather than being designed specifically for a particular customer. In such cases, an entity shall include in its analysis when determining whether an asset has an alternative use, whether the asset could readily be directed to another customer without incurring significant costs (for example, to carry out significant modifications to the asset), in the event of default by the original customer. A promised asset would not have an alternative use to an entity if the entity is unable, either contractually or practically, to readily direct the asset to another customer. For example, an asset would have an alternative use to an entity if the asset is largely interchangeable with other assets that the entity could transfer to the customer without breaching the contract and without incurring significant costs that otherwise would not have been incurred in relation to that contract. An asset would also have an alternative use to an entity if, in the event of default by the existing customer, the asset could be redirected to another customer without significant costs being incurred (for example, to rework the asset). Conversely, the asset would not have an alternative use if the contract has substantive terms that preclude the entity from directing the asset to another customer and, in the event of customer default or if the entity would incur significant costs (for example, to rework the asset) to direct the asset to another customer.’

Question 2

Paragraphs 68 and 69 state that an entity would apply Topic 310 or IFRS 9 (or IAS 39 if the entity has not yet adopted IFRS 9) 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 agree with the proposals. However, we note that the exposure draft does not specify the Boards’ precise intent with respect to presenting the effects of credit risk "adjacent to” revenue. Some practitioners might interpret this to mean credit adjustments would be a deduction to arrive at net revenue, while others may understand it as a deduction from revenue to arrive at gross profit. Therefore, we recommend that the Boards clarify their intentions with an illustration to eliminate any potential confusion. We believe that it would be appropriate for the separate line item to appear immediately after revenue, with a subtotal being included for net revenue.
Additionally, we note the Boards’ observation that for some industries (for example, healthcare), it can be difficult to distinguish a billing adjustment from other credit adjustments. We believe the final standard could be improved by treating billing adjustments and bad debts consistently, rather than leaving practitioners to distinguish between them, which brings the risk of inconsistency.

**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?

We agree with the proposed constraint on revenue recognition. However without clarification, we believe that the phrase “reasonably assured” is likely to be interpreted differently across jurisdictions. We note the concept of reasonable assurance has different connotations in IFRS compared to US GAAP, as does the term “probable.” Whether the final amendments retain the phrase “reasonable assurance” or use different language, the Boards should define these terms in order clearly to convey their intent to establish a high hurdle. Otherwise, a lesser, ambiguous threshold would be tantamount to no constraint at all. It would, however, be preferable to use existing terms that are already used in the accounting literature in order to avoid introducing additional thresholds and associated complexity.

In addition, paragraph 51 specifies that the determination of the transaction price assumes the contract “will not be cancelled, renewed, or modified.” However, Examples 14 and 25, both refer to cancellation and renewal provisions. We believe the Boards intend for the terms of the original contract to govern the selling price estimate, including the effect of options to cancel or renew. If our understanding is correct, we recommend rephrasing paragraph 51 as follows (marked for changes):

‘For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed, or modified from its original terms.’

Lastly, it is not clear whether a link is intended to be made between paragraphs 55 and 81. A contact might include a bonus payment for the vendor, for which the probability of achieving the bonus criteria is 60%, which is a lower threshold than “reasonably assured”. If a link is intended, it is not clear whether the provisions of paragraph 81 would override those of paragraph 55 and preclude the recognition of any amount related to the bonus until its receipt became “reasonably assured”.
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 strongly disagree with the proposals, and believe that they could give rise to misleading accounting. An arbitrary one-year threshold would ignore potentially material onerous losses for short term contracts that span reporting periods. For example, an entity may enter into a contract on 30 June expecting to complete it profitably in 10 months. By 31 December, conditions have changed and the entity now expects to incur a loss on the contract. A one year threshold would not reflect the onerous loss at year-end, an outcome we do not support. We believe contracts should be evaluated at each reporting period for onerous losses. In this context, we note inventory and other types of assets are assessed for impairment at each reporting period.

We see no reason why the requirements of IAS 37 should not apply to contracts within the scope of the proposals in the ED.

We understand the Boards’ proposed a one-year threshold in part to provide relief from the effect of the decision to apply the onerous test at the performance obligation level, rather than at the level of the entire contract. We continue to disagree with this approach. While we acknowledge it is inconsistent to recognise revenue for performance obligations and test for onerous losses using different units of account, we believe the Boards have received ample feedback that recording losses on components of contracts that are, when viewed as a whole, profitable does not provide decision-useful information. Further, we disagree with the notion in BC207 that assessing losses at the contract level is somehow complex. For example, a supplier of office equipment might supply the hardware at an amount below cost together with a maintenance contract. The two components, when combined, are profitable and we do not see a sustainable argument for recording a loss on the sale of the hardware and enhanced profits for the maintenance. The same notion applies in other industries, such as aircraft engine manufacturers. In neither of these cases are there significant difficulties in establishing the outcome from the overall contract as being profitable.

The Boards also cite concerns about abuse as a basis for performing the onerous test at the performance obligation level. Historically, we note practitioners have addressed questions regarding when it is appropriate (and when it is not) to combine contracts for purposes of revenue recognition. We believe this should continue to be addressed as a practice issue rather than a standard-setting issue.

Lastly, we understand onerous losses would be recognised “if” the lowest cost of settling the performance obligation exceeds the transaction price allocated to it (instead of “if”, BC214 uses the term “when”). We interpret “if” and “when” consistent with the “more likely than not” threshold in IAS 37. If the Boards’ intent is different, additional clarification would be needed in the final standard.

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2 Provisions, contingent liabilities and contingent assets. See paragraph 23.
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 fulfill 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 believe revisions should be made to both the annual and interim disclosure requirements.

Disaggregation

Paragraph 114 requires a disclosure of disaggregated revenue based on “primary categories,” which could be based upon the type of good or service sold, geography or customer class. As the Boards are aware, similar segment disclosures are required under existing US GAAP and IFRS. We do not believe the disaggregated revenue disclosures have a fundamentally different objective than segment disclosures. As such, we recommend requiring disaggregated revenue information under a single standard, rather than two. Otherwise, there may be confusion in practice as to whether the disclosures provided under one standard will suffice for the other.

Contract balances

Example 17 provides illustrative journal entries to reflect activity in contract assets and liabilities. We would have expected the journal entries to correspond to the date that either the entity or the customer performed based on the guidance in paragraph 104 (which we note is inconsistent with paragraph 105 which implies that an entity should record an asset at the point at which a payment in advance is due for payment). The example indicates a receivable is recorded prior to either party’s performance. We suggest that the inconsistency is eliminated by amending paragraph 105 and that consequential amendments are made to example 17 (please see our comments below in respect of Example 17 and the inconsistency of the proposals with existing guidance in IAS 32).

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3 For example, ASC 280-10-50-21 and IFRS 8 require segment disclosures based upon the entity’s basis of organisation, such as products and services, geographic environments, regulatory factors, etc.
In addition, the Boards may wish to reconsider whether the entire tabular reconciliation in Example 19 is necessary. Our expectation is that the most useful information would relate to key judgments, for instance how the entity measured progress during the period for performance obligations satisfied over time. We are less certain users would find significant benefit in disclosures about routine changes in contract assets and liabilities, such as customer prepayments or product shipments. A more targeted disclosure approach that focuses on judgmental areas would likely be more cost-beneficial than the comprehensive schedule in Example 19.

Remaining performance obligations
We note the term “backlog” is generally undefined, although many preparers provide backlog information in a narrative format that is separate from, but supplemental to the audited financial statements (e.g., Management’s Discussion and Analysis in the US). Since backlog disclosures will often encompass possible sources of future revenue that go beyond the remaining performance obligations in paragraph 119(a), confusion may result when comparing such narratives with the audited footnotes. As such, we are not convinced the requirements in paragraphs 119-121 will be particularly helpful.

Onerous performance obligations
As noted above, we recommend addressing onerous obligations at the contract level, rather than for each performance obligation. As such, we would base the disclosures on the entire contract. Nonetheless, if onerous obligations are based on individual performance obligations, we believe some companies will have an incentive to disclose why such expenses represent “investments” in the related contract rather than true losses. That scenario calls into question the usefulness of the tabular reconciliation requirement in paragraph 123 in the way that it is currently drafted.

Interim disclosures
While the preceding comments would apply equally to annual and interim financial statements, the Boards should clarify interim disclosure requirements to ensure that these are not excessive. Specifically, an assumption exists that users of interim statements have read the most recent annual statements. Therefore, interim disclosures should provide an update regarding “judgments, and changes in the judgments, made in applying” the final standard during the interim period. We note that IAS 34.6 states that “[t]he interim financial report is intended to provide an update on the latest complete set of annual financial statements. Accordingly, it focuses on new activities, events and circumstances and does not duplicate information previously reported”. In this context, we recommend the Boards review the proposed interim disclosures with a view to providing more discretion for preparers to determine which elements of the annual disclosures should be updated on an interim basis. We also believe that, if the Boards do include reference from IAS 34 to specific paragraphs included in the ED, it is essential that paragraph 110 is specifically included.

Initial adoption
At adoption, entities in some jurisdictions will be required to present comparative financial information covering a period of more than two years. While the requirement for information in excess of the requirements of IFRS (or US GAAP) is a matter for regulators in each jurisdiction, it would be helpful for the Boards to give consideration to this point. This might be addressed in the first year of adoption by providing transition relief stating disclosures are required only for the most recently completed period. We provide further thoughts on transition below.
Question 6

For the transfer of a nonfinancial 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 nonfinancial assets that are not an output of an entity’s ordinary activities? If not, what alternative do you recommend and why?

We agree that the same proposed control and measurement guidance should apply. However, we believe the final standard should more specifically state that income from non-routine transfers is precluded from being classified as revenue.

In addition, we note that the transfer of title is an indicator, rather than a requirement, that control has transferred under the exposure draft. It is our sense that in most non-routine asset sales, practitioners have generally viewed the legal transfer of title as a necessary condition for income recognition (as opposed, for example, to being leased to a third party under a finance lease). As with other transactions in the scope of the ED, by relaxing the role that a legal transfer of title plays to recognise revenue, the ability to recognise income without transferring title may result in inconsistent conclusions, particularly across legal jurisdictions. While we do not believe a separate model is needed for non-routine asset sales, it might be helpful for the Boards to acknowledge this potential in the application guidance to the final standard.

Other Comments, with paragraph references

Combination of contracts (16-17)
Paragraph 17 provides guidance for the combination of contracts and states that “an entity shall combine two or more contracts entered into at or near the same time with the same customer....” We believe that the phrase “at or near the same time” is subject to varying interpretations. Accordingly, we believe the Boards should clarify that “at or near the same time” is intended to be a relatively short period of time.

Output methods (43 and BC120)
For performance obligations satisfied over time, the exposure draft notes that appropriate methods of measuring progress include both output and input methods. Paragraph BC120 suggests that an input method should only be used if an output method is unnecessarily costly to apply. In addition, paragraph 43 indicates an input method “may be necessary” if there are disadvantages associated with an output method. As such, both paragraphs seem to imply a preference for output methods. If the Boards have such a preference, we believe it should be more explicitly stated in the text of the standard.

Recognition of revenue, and reasonably assured (49 and 81 - 85)
The heading to paragraph 49 refers to the measurement of revenue, while the text of the paragraph itself refers to the amount that is recognised by an entity. We suggest that the heading or the text is amended to be consistent.
The requirement for variable revenue to be reasonably assured is included in both of these paragraphs. Since paragraphs 81 - 85 cover this point specifically, we suggest that a clear reference to those paragraphs is included in paragraph 49.

**Time value of money (58)**

Paragraph 58 states a financing component exists if the amount of consideration differs from the cash selling price that would apply at the time the goods or services are actually transferred to the customer. It is unclear how an entity would determine what the cash selling price would be, particularly in a situation where a customer has prepaid. In effect, the entity would be required to determine what the cash selling price would be in the future. Further, Example 9 does not address how the entity concluded that the cash selling price in the future would actually be more, i.e., that a financing component existed. Rather, it simply provides a present value calculation without a supporting justification. We believe additional implementation guidance is needed to address these concerns, as many preparers have not previously performed time value calculations for purposes of revenue recognition. The need for such guidance will be particularly important in high interest rate environments. In such jurisdictions, we do not believe the one-year practical expedient in paragraph 60 would be appropriate.

**Non-cash consideration (63)**

It is not clear from the text as drafted, when the fair value of non-cash consideration should be determined. This is particularly relevant where one or more performance obligations are satisfied over time and a vendor’s entitlement to consideration arises in stages (for example, a contract for services provided over a period of time, where the customer issues equity instruments in settlement of amounts due rather than paying in cash). We assume that the final remeasurement should be at the point at which the vendor recognises an asset for the consideration receivable, and it would be helpful for this point to be clarified. In this context, we note an initial estimate of fair value would have to be performed at Day 1 in order to allocate consideration to multiple performance obligations.

**Performance obligation vs protective right (837)**

We note that the customer might be required to pay in advance for the use of the intellectual property (for example, exclusive film rights in a number of specified jurisdictions). Consequently, a prepayment asset might be recognised, meaning that the defending of the patent may protect an asset of the customer as well as the intellectual property. This might be considered to give rise to a performance obligation. We suggest that the text of this paragraph is amended to clarify whether a performance obligation arises in those circumstances.

**Example 4 - Significant customisation of software**

While we do not disagree with the example, we consider that the conclusion that revenue would be recognised over time ‘assuming the criteria in paragraph 35 are met for satisfaction of a performance obligation over time’ is a substantial assumption. We suggest that instead of specifying whether revenue is recognised over time, or at a specific point, that reference is made to revenue being recognised in accordance with the guidance at specified paragraphs of the standard.

**Example 5 - Construction**

We suggest that a similar amendment is made to that suggested above for Example 4.
**Example 12 - Multiple performance obligations**

It is not readily apparent how the allocation of consideration in scenario 1 is “consistent with the allocation principle in paragraph 70 when considering the other payment terms and performance obligations in the contract,” while the allocation is not consistent in scenario 2. The statements are made without a supporting analysis or basis for conclusion. Practitioners might infer that allocating the entire contingent payment to License B is appropriate in Scenario 1 because it does not exceed its estimated sales price ($900 compared to $1,000), whereas it would be inappropriate in Scenario 2 because the contingent amount is greater than its estimated sales price ($1,500 compared to $1,000). In any event, we believe the Boards should more clearly articulate the reason for the distinction between the two scenarios relative to the two conditions in paragraph 76.

Also in Scenario 1, we would more clearly link the treatment of the $100 discount to paragraph 75(b), in which the discount is attributed to a single performance obligation. In this context, we note the effect of Scenario 1 is to recognise revenue based upon prices stated in the contract. Citing paragraph 75(b) will provide a more explicit contrast with Scenario 2, in which stated prices differ more significantly from estimated sales prices and consideration is allocated on a pro rata basis.

The fourth paragraph in Scenario 1 refers to amounts that the entity “is not reasonably assured to receive...” We recommend rephrasing this sentence to refer to amounts to which the entity “is not reasonably assured to be entitled...”

Finally, we note that revenue for License B is recognised only when subsequent sales occur. This implies that the proposals are inconsistent with the amortised cost accounting for financial assets and liabilities, in accordance with IAS 39 and IFRS 9 which require financial assets and liabilities to be measured on the basis of expected cash flows. Alternatively, the intention in the example might be for the vendor to recognise a financial asset in accordance with the requirements for financial instruments, which would give rise to deferred revenue being recognised. We suggest that the example is amended to include the accounting for the financial asset and, if an inconsistency is intended (with which we would strongly disagree), that inconsistency is fully justified in the Basis for Conclusions.

**Example 13 - Management fees**

It is not clear how the conclusion in the second paragraph, that each increment of service is distinct in accordance with paragraphs 28 and 29, has been reached. The contract is for the provision of services for a period of one year, and we do not see how an entitlement to quarterly payments changes that contractual arrangement.

We suggest that the example is revised.
Example 17 - Contract liability and receivable
We note that in the example, the contract is entered into on 1 January with payment being due on 31 January. Following the fact pattern, it is not clear why an asset for the receivable is not recognised as at 1 January, as it is on this date that the right to receive €1,000 on 31 January is established.

We also note that this example is inconsistent with the guidance at IAS 32.421, which notes that:

'A contract that involves the receipt or delivery of physical assets does not give rise to a financial asset of one party and a financial liability of the other party unless any corresponding payment is deferred past the date on which the physical assets are transferred. Such is the case with the purchase or sale of goods on trade credit.'

We suggest that example 17 is amended to be consistent with IAS 32 and also paragraph 104 of the ED, under which the receivable would be recognised when performance occurs (please also see our comments in response to question 5 above).

Transition matters
Paragraph 133(a) states “For contracts completed before the date of initial application, an entity need not restate contracts that begin and end within the same annual reporting period.” Through informal discussions with IASB and FASB staff members, we understand that the term “completed” refers to contracts as completed under the ED, rather than prior IFRS or US GAAP. As such, entities would need to determine whether contracts would be considered complete under the new standard (and in effect, adopt it) to determine their eligibility for the transition relief in paragraph 133(a). This circularity largely defeats the purpose of providing relief.

In addition, we note that contracts ending in the fourth and fifth year prior to the initial year of adoption might not be eligible for the transition relief provided in this paragraph. For example, assume a US registrant presents the years ended 2013-2015 in the 2015 Form 10-K. If a six month contract began in 2011 and was completed in 2012, it would not begin and end within the same annual period. Therefore, it would not be eligible for the relief in paragraph 133(a), which would impact how the 2011 and 2012 periods would be presented in the registrant’s five year table in the Form 10-K. We recommend providing more explicit relief for such situations in the final standard. Alternatively, the FASB staff might wish to liaise with staff of the Securities and Exchange Commission on this point.

Lastly, paragraph 134(b) requires disclosures related to any practical expedients that have been used to the extent that providing them is “reasonably possible.” We believe this is too low a threshold, and that such disclosures should be provided unless it is “impracticable” to do so.