Mr. Hans Hogervorst, Chairman  
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30 Cannon Street  
London, EC4M 6XH  
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Submitted via electronic mail to iasb@iasb.org

Joint FASB/IASB Exposure Draft Revenue from Contracts with Customers  
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Dear Mr. Hogervorst,

We would like to thank you for the opportunity to comment on the joint FASB/IASB Exposure Draft “Revenue from Contracts with Customers”, issued in November 2011 (henceforth “the ED”). Thank you also for providing us with the opportunity of meeting IASB staff members during workshops and field tests to discuss the ED proposals: We have invariably found the discussions with staff members extremely helpful and constructive.

As a leading player in the aerospace industry, our major concern is with the future of contract accounting under the proposed revenue recognition principles. We greatly appreciate the Boards’ consideration of many of the concerns expressed by us and others in previous comment letters on the revenue recognition project, in particular with respect to contract accounting. As a general remark, we are clearly supportive of most of the changes made to the initial guidance set out in the 2010 Exposure Draft.

This being said, we continue to have some concerns with certain ED proposals or consider the guidance provided to merit clarification in some respects. Our concerns and requests for clarification may be summarised as follows:

<table>
<thead>
<tr>
<th>Topic</th>
<th>Step in recognition process</th>
<th>Comment/Request</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Performance obligations satisfied over time (ED Question 1)</td>
<td>Step 5: Recognise revenue when performance obligation is recognised</td>
<td>Provide additional guidance on when control of WIP transfers to customer (specifically in situations where constructor retains physical possession of WIP), and clarify the role of customer options to take over WIP.</td>
</tr>
<tr>
<td>Topic</td>
<td>Step in recognition process</td>
<td>Comment/Request</td>
</tr>
<tr>
<td>------------------------------------------------------------</td>
<td>----------------------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>B. Constraining amount of revenue recognised (ED Question 3)</td>
<td></td>
<td>Clarify (i) that in contracts that include both fixed &amp; variable price components, the revenue recognition constraint only applies to the variable portion of overall compensation, and (ii) that absent predictive experience with similar performance obligations, revenue recognition may still be appropriate if predictive experience with factors that give rise to variability exists.</td>
</tr>
<tr>
<td>C. Measuring progress towards completion</td>
<td></td>
<td>Clarify whether a single performance obligation satisfied over time may be accounted for using different measures of progress for the different phases of activity (e.g., cost-to-cost for the development phase &amp; unit-of-delivery for the production phase).</td>
</tr>
<tr>
<td>D. Onerous performance obligations (ED Question 4)</td>
<td>—</td>
<td>Our 2010 concerns with respect to basing the onerous test on single performance obligation rather than entire contract seem to be resolved; however, inconsistency seems to exist between IAS 2.31 and amended scope of IAS 37, and between treatment of (short-term) warranties in the scope of the proposed standard and those in the scope of IAS 37.</td>
</tr>
<tr>
<td>E. Time Value of Money</td>
<td>Step 3: Determine the transaction price</td>
<td>Reconsider the implications that the time value of money guidance may have on performance obligations satisfied over time.</td>
</tr>
<tr>
<td>F. Single performance obligations</td>
<td>Step 2: Identify separate performance obligations</td>
<td>Clarify that bundle may be composed of a subset of the overall goods and services promised in the contract.</td>
</tr>
<tr>
<td>G. Disclosure requirements</td>
<td>—</td>
<td>Requirements excessive and unjustifiable under cost-benefit considerations.</td>
</tr>
</tbody>
</table>

You will find a detailed discussion of our views in the Appendix to this letter. We would be pleased to further discuss them with the Board or its staff at your convenience. If you wish to do so, please contact Carsten Schween (at carsten.schween@eads.net or +49 89 607-34251).

Yours faithfully,

(Joachim Feyel)

Chief Accounting Officer
APPENDIX -

A. Performance obligations satisfied over time (Comment to Question 1 relating to Step 5: Recognise revenue when performance obligation is recognised)

We appreciate the Boards efforts to develop further guidance that may assist in determining when performance obligations are satisfied over time, i.e. when percentage of completion ('PoC') accounting should be applied. We applied the ED guidance to various types of contracts in our business, and generally found it to be pertinent and practicable. The guidance not only allowed us to use PoC accounting where we thought such outcome to be economically sensible, it also disallowed PoC for contracts that we consider not eligible for PoC accounting.

Still, discussions with our peers revealed that the guidance might be differently construed and hence merit further clarification.

Specifically, there seem to be different interpretations under paragraph 35(a) of the conditions that should be met for work in progress ('WIP') to be considered controlled by the customer as it is created or enhanced. Paragraph 35(a), by referring to the paragraphs that describe control, implies that control of WIP should be assessed in terms of which party has the ability to direct the use of and obtain substantially all of the benefits of WIP (or which party has the ability to prevent others from directing its use and obtaining these benefits). However, the ED does not provide any further guidance on when this ability should be deemed to exist for the customer. Such further guidance might be particularly helpful in situations where the WIP remains on the constructor’s premises outside the immediate reach of the customer.

Such situations where the constructor retains physical possession of the WIP are typical of our business, and when applying the ED guidance to our contracts we have used the following indicators to determine whether the customer is in control of WIP:

a) WIP is created or enhanced according to the customer’s specifications;

b) the customer has the right to change those specifications (potentially subject to contract price adjustments);

c) the customer is closely involved in the manufacturing process; e.g. the customer defines, approves or changes the product’s specifications, has the right to inspect WIP and accepts or rejects performance to date at several stages throughout the construction process;

d) the customer has the right (typically through ‘Termination for Convenience’ clauses) to take over the WIP at its option, usually in exchange for paying for the work performed to date.

Concerning c), close involvement of the customer in specifying the design of the product and the manufacturing process is a concept that was used in the 2010 Exposure Draft (e.g. in Example 15) as an indicator of continuous performance. We found this reference of a close customer involvement helpful in assessing whether control transfers to the customer over time rather than at a point in time, and would like to encourage the Boards to take it up again.

Concerning d), we discussed ‘WIP take-over’ options during an EFRAG field test, and found that some participants would argue that such options do not convey control of WIP. Rather control of WIP (in their view) would only transfer to the customer once there is an obligation on the customer’s part to take over WIP. We do not concur, and hold that a ‘WIP take-over’ option
transfers control of WIP to the customer provided it effectively prevents an entity (during the option’s life) from redirecting the WIP to another customer. It would seem to us that a ‘WIP take-over’ option should normally have just this effect.

In addition, our view that a ‘WIP take-over’ option conveys control of WIP to the customer is further based on the following two considerations.

First, BC91, quoting paragraph 22 of AICPA SOP 81-1 (and confirming that the SOP 81-1 view quoted is in line with the ED’s concept of control), considers that ‘the buyer’s right to take over the work-in-progress at his option […] provides additional evidence to support [the] view’ that ‘the contractor has, in effect, agreed to sell his rights to work-in-progress’ [our italics].

And second, paragraph B40 argues with respect to repurchase agreements that a seller’s right to repurchase at his option an asset sold is sufficient to conclude that the customer does not obtain control of the asset ‘because the customer is limited in its ability to direct the use of and obtain substantially all of the remaining benefits from the assets (even though the customer may have physical possession of the asset). By analogy, if a constructor is limited in its ability to direct the use of and obtain substantially all of the remaining benefits from the WIP (even though the constructor may have physical possession of the WIP), the constructor no longer controls the WIP. Consequently, the existence of WIP take-over options should be considered sufficient evidence that control has transferred to the customer.

We would like to encourage the Boards to provide additional guidance on when control of WIP would be considered transferred to the customer in situations where a constructor continues to have physical possession of the WIP. Also, as it appears from the above that a WIP take-over option alone might be sufficient to conclude that control of WIP has transferred to the customer, we would appreciate if the Boards further considered whether this is really the case, and, if so, amend the guidance accordingly.

(Please note that if this is the case, ‘a contract that precludes the entity from transferring the WIP to another customer’ alone would indicate that related performance obligations are satisfied over time, and Example 7, which discusses such contracts in the context of alternative use, might have to be amended.)

B. Constraining amount of revenue recognised (Comment to Question 3 relating to Step 5: Recognise revenue when performance obligation is recognised)

With variable consideration, paragraph 81 constrains the cumulative amount of revenue to be recognised to date to the amount to which an entity is reasonably assured to be entitled. The paragraph further explains that reasonable assurance may only exist if an entity has experience with similar types of performance obligations (or has other evidence such as the experience of other entities) and this experience (or other evidence) is predictive of the amount of consideration.

Although we agree with the principle of constraining revenue recognition in certain situations, we are concerned that the guidance, such as it is currently laid down, might prove too restrictive with certain contracts. Consider a contract which provides for a fixed minimum compensation plus a variable amount based on some factor outside the entity’s influence or experience. We would think that the entity should not be prevented from recognising revenue for the fixed minimum amount even if the entity lacks experience with similar performance obligations (or other evidence) or its experience (or other evidence) is not predictive of the
amount of consideration. From the current wording of paragraph 81 it is not entirely clear
whether an entity may recognise revenue for the fixed minimum amount in such situations.
Assuming the Boards do not intend to constrain revenue recognition for the fixed portion of
consideration amounts that are otherwise variable, we would recommend that the final
standard includes a clarification to the effect that the revenue recognition constraint only
applies to the variable portion of the overall compensation.

In addition, we are not sure that predictive experience with similar types of performance
obligations (either the entity’s own or that of others’) should always be required as a
prerequisite for the recognition of variable amounts of revenue. Requiring predictive
experience with similar performance obligations to exist at all events implies that absent such
experience reasonable assurance about the outcome of the variability may not be obtained.
This implication, however, may not always be true. Consider a ten year maintenance service
contract for certain newly developed aircraft components that provides for compensation to be
based on flight hours. Because of the components’ newness it is unclear when and how often
maintenance and overhaul services will be required during the contract term. In such a
situation, the entity obviously lacks experience with similar performance obligations (and does
not have other evidence), although it may well have experience with the factors that give rise to
the variability of compensation amounts, and so be reasonably assured of the number of flight
hours to be expected to occur over the contract term. We think that revenue recognition would
be appropriate in this case. Hence, we would suggest including guidance to the effect that
whenever an entity does not have experience with similar types of performance obligations,
reasonable assurance may exist and revenue recognition be appropriate if the entity has
experience with the source(s) of variability, and that experience is predictive of the amount of
consideration to which the entity is entitled.

C. Measuring progress towards completion (Comment relating to Step 5: Recognise
revenue when performance obligation is recognised)

Paragraph BC231 implies that a contract to deliver a specified number of units may constitute a
single performance obligation. From discussions with IASB staff, we understand that this will
typically be the case when the conditions in paragraph 29 are met for such a contract, eg when
in addition to delivering a number of highly customised units, the contract (implicitly or
explicitly) requires an entity to perform development activities that are highly interrelated with
the construction of the units.

Assuming the single performance obligation would be considered satisfied over time according
to paragraph 35, it is unclear to us whether the ED would allow using an input based measure
(such as cost-to-cost) for the development activities and an output measure (such as units-of-
delivery) for the production phase. From publications issued on the ED, it appears that at least
one of the Big-4 audit firms would consider inappropriate an approach that measures progress
towards completion by separately considering the consecutive stages of activity required to
satisfy the performance obligation and measuring progress towards completion using a
different method depending on the stage of activity that has been reached. This view that for
single performance obligations satisfied over time only one method of measuring progress
towards completion may be used, might derive from paragraph 40 which states ‘For each
separate performance obligation [...] an entity shall apply a method of measuring progress that
is consistent with the objective in paragraph 38’ [our italics], implying by the singular form that
using more than one method for a single performance obligation would not be appropriate.
We do not think that using different methods for separate phases of satisfying a single performance obligation would disagree with the objective in paragraph 38, which is for the measurement methods ‘to depict the transfer of control of goods or services to the customer—that is, to depict an entity’s performance.’ For instance, we would consider an approach that applies a cost-to-cost measure during the development phase and switches to a units-of-delivery method once production has begun to be justifiable on the grounds that a unit-of-delivery method is a faithful depiction of performance during the production phase but is not available for the development phase because of the difficulty of defining ‘development units’.

We would like to ask the Boards to clarify this point in the final standard.

D. Onerous performance obligations (Comment to Question 4)

In our comment letter on the 2010 Exposure Draft we argued that an onerous test should be applied to individual contracts rather than individual performance obligations. Our main concern with the approach proposed in the 2010 Exposure Draft was that, different from current practice, the effects of learning costs could require us to recognise upfront losses for the early units produced under a contract to deliver multiple units, although the contract as a whole is expected to be profitable.

Thanks to the discussion of learning curve issues in BC230 et seq, it now appears that with contracts for the delivery of multiple units giving rise to a single performance obligation satisfied over time, the individual performance obligation to which the onerous test would apply typically encompasses all the units promised in the contract. So, effectively, for such contracts the outcome of an onerous test would be the same as if the test were applied at contract level.

Furthermore, as a result of restricting the requirement to perform an onerous test to performance obligations satisfied over time, those contracts for the delivery of multiple units that give rise to performance obligations satisfied at a point in time continue to be subject to the requirements of IAS 2, and hence, as pointed out in BC210, to the existing onerous contract provisions of IAS 37.

Thus, the BC clarifications made with respect to learning costs, and the restricted scope of the onerous test, would seem to have effectively resolved the concerns we had in this area.

Still, we would like to mention two additional points for your consideration:

First, from D21 it appears that the scope of IAS 37 has been amended to exclude rights and obligations from contracts with customers that are in the scope of the new IFRS. As a result, we think that losses from firm sales contracts (in excess of inventory quantities held) would no longer be considered in the scope of IAS 37. To the extent that these sales contracts require performance at a point in time, this is in contradiction to paragraph 31 of IAS 2 (and BC210). (Besides, Appendix D does not yet include an amendment to the part of IAS 2 scope section that currently addresses work in progress under IAS 11.)

And second, BC208 states that the practical expedient of limiting the onerous test to performance obligations that an entity expects at contract inception to satisfy over a period of time greater than one year was introduced to align the scope of the onerous test under the proposed standard with onerous test scope in IAS 11. We note that the proposed scope restriction also affects long term service contracts, and although IAS 18.21 considers IAS 11 requirements to be generally applicable to the recognition of service revenue and related
expenses, it is unclear whether a practical expedient similar to the one proposed currently applies to short term service contracts. Furthermore, as there is no such practical expedient in IAS 37, warranties that do not qualify as separate performance obligations may be subject to different onerous test requirements than those that do.

E. Time value of money (Comment relating to Step 3: Determine the transaction price)

We think the guidance on when adjust the amount of consideration for the time value of money, by clarifying that factors other than the length of time between performance and payment may determine whether a financing component is significant (and hence should be reflected in revenue), is certainly an improvement to the guidance given in the 2010 Exposure Draft. We also think the ED proposals are sufficiently clear and unambiguous to be applied, without undue cost, to those types of performance obligations satisfied at a point in time that we face in our business.

However, we are unsure whether the same is true for contracts in which performance obligations are satisfied over time. With such contracts, it appears that, generally, a significant financing component would only arise under the ED proposals, if the pattern of recognising revenue (reflecting the transfer of control of goods or services to the customer) significantly differs from the pattern of cash received from the customer.

We note that eg for upfront payments made by the customer under such contracts, the amount of revenue attributable to the financing component would differ according to the method chosen for measuring progress, rather than according to the amount and timing of the financing provided. For instance, if upfront payments are significant, a cost-to-cost approach to measuring progress might ceteris paribus result in significantly less contract revenue than a milestone approach.

Furthermore, we note that under a cost-to-cost approach to measuring progress, the outstanding nominal of an upfront payment would diminish whenever contract cost are incurred, and hence calculating the amount of interest to be included in revenue might prove an operational challenge.

We therefore would like to suggest that the Boards reconsider the implications, in terms of both accounting outcome and practicability, that the time value of money guidance might have for performance obligations satisfied over time.

F. Identification of single performance obligations (Comment to Step 2: Identify separate performance obligations)

Paragraph 29 requires to account for a bundle of promised goods or services as a single performance obligation if the goods or services are highly interrelated and require the entity to provide significant integration and customisation efforts. We think the guidance works well with contracts in which all goods and services promised in the contract are subject to the integration and customisation efforts.

However, it seems to be less straightforward if applied to contracts that require integration and significant customisation of only parts of the overall goods and services promised in the contract (with the remainder of the promised goods or services not being subject to such integration or customisation efforts). For example, a contract might require (i) the construction
of an infrastructure and (ii) its subsequent operation once construction is complete. The wording of paragraph 29 might be read (and should be read according to what we think is the underlying concept) to require accounting for the construction of the infrastructure as a single performance obligation, and separately accounting for the operation service. However, another reading might conclude that the diverse construction activities should not be considered a single performance obligation because the overall bundle includes an operation service that is neither highly interrelated with the rest nor subject to significant integration and customisation. For the same reason, yet another reading might consider construction and operation services to constitute a single performance obligation. The second and third reading tacitly (and we would think erroneously) assume that 'bundle' always relates to the entirety of goods and services in a contract (and so conclude that either all or none of the promised goods or services should be combined).

These latter readings could be avoided by clarifying that 'bundle' might refer to only a subset of the entire goods or service promised in a contract.

**G. Disclosures requirements**

We continue to think the disclosures required by the ED to be excessive, and do not think that, or fail to see why, disclosures such as the required reconciliations of contract balances and onerous performance obligations would provide decision useful information to users. We note that the collection and preparation of the data required will be an 'accounting-only' exercise that will divert our limited internal resources away from other financial reporting areas that we consider to be of more interest to users. Furthermore, data collection and preparation will require significant system changes, and we greatly doubt that the associated increase in cost will justify the benefits to be derived from them.