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International Accounting Standards Board 30 Cannon Street London EC4M 6XH United Kingdom

Dear Sir/Madam

Re: Preliminary Views on Revenue Recognition in Contracts with Customers

We are pleased to be able to present our comments on the Discussion Paper Preliminary Views on Revenue Recognition in Contracts with Customers ("DP").

Firstly, we would like to say that we welcome the opportunity that the DP has given to consider in some detail this subject. We believe its importance stems from the fact that Revenue is one of the key figures for all users of financial statements and also because of the existing inconsistency in the principles applied in IAS 11 and IAS 18. It is also a fundamentally important area to be tackled as part of the convergence for IFRS and US GAAP.

We would like to comment by addressing the questions which the DP poses.

Questions

- 1. Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?
- 2. Are there any types of contracts for which the boards' proposed principle would not provide decision useful information? Please provide examples and explain why. What alternative principle do you think is more useful in these examples?
- 3. Do you agree with the boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

Response

We agree that a single and unified approach to revenue recognition is desirable rather than the current situation which has more than one approach and where these approaches often lead to an inconsistent treatment of what are in reality the same or similar transactions.

We understand that the current proposal requires performance obligations under a contract to be measured and recognized separately to accurately reflect the transfer of assets (in the form of goods or services) to the customer over the life of the contract. We believe, however, that the key issue in the case of a deliverer of services will be to identify the timing of that transfer of control of an asset to the customer. This will be particularly problematic in the case of services which work towards completion of a future deliverable. We believe that additional guidance is required in the standard to clarify how this transfer can be measured.

The proposed measure of changes in an "entity's contract asset or liability" to gauge the satisfaction of a performance obligation may not in practice be so easy to comprehend and, therefore, estimate. We are also concerned that the satisfaction of a performance obligation should also be a good reflection of the effort put in by the supplying entity and provide an example in the response to question 2 of how this might not be the case.

In response to question 2, the construction contracts we see in a number of industries would be clear examples where the proposed principle might in certain cases not provide useful information. For example, in the IT industry it is not unusual for a supplier to enter into a contract to develop and build a system. Because of the complex nature of the contract, the system may have to be designed, developed and built at the supplier's premises and only near the end of the whole project is it delivered to the final customer; in some cases the system may just come into service remotely from the customer and never be "delivered". If we are not able to determine the satisfaction of a performance obligation on an interim basis thoughout a project, the satisfaction of a performance obligation approach could well mean that most or even all of the revenue is delayed to the end of the project. In this case revenue would not be a good measure of the work that the supplier has been doing and a user of the financial statements would gain an incomplete picture of the Company's activities.

As the difference between whether an entity can recognize revenue or not could depend on the way a "long-term" contract is delivered, we believe that guidance should be provided which allows an assessment of the transfer of control to the customer and, therefore, the recognition of revenue. We would expect that revenue for a contract along the lines of the one described here should be recognized throughout the life of the contract. Although we would not expect revenue to be accrued constantly under the new proposal, it would be probable that revenue would be periodically recognized based on "events" being reached which signify a level of performance obligation being satisfied.

We understand question 3 addresses the fact that the boards want to adopt a definition for a contract. The proposal is acceptable as it is a broad definition which should encompass all types; although if the goal is a convergence of standards it seems logical that the current definition appearing in IAS 32 which is quoted should now be replaced also by this new definition.

Questions

- 4. Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.
- 5. Do you agree that an entity should separate performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?
- 6. Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?
- 7. Do you think that sales incentives (eg. discounts on future sales, customer loyalty points and "free" goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

Response

Generally speaking, we believe that identifying individual performance obligations will not be easy and will need specific guidance. In our example of a system build in the IT Industry, determining the various components and then establishing when they are delivered will require the consideration of a number of elements within the contract such as milestones.

In addition, we believe the resolution of whether certain sales incentives (discounts, etc) or warranties are separate performance obligations is problematic. The guidance provided in the DP is general and a consistent interpretation will not always be easy. Generally speaking, however, we believe that the existence of a warranty commitment or a right to refund should not preclude the recognition of the sales revenue. We do not believe that the "failed sale" which is described in paragraph 3.39 should apply as that would require inventory which had been sold to stay in the supplier's balance sheet. If the situation gives rise to possible future costs (which an entity can estimate based on past experience as a percentage of returns) we believe these should be provided as such rather than holding back the recognition of revenue.

In addition, we believe that if a standard warranty is supplied at the time of sale of goods to all customers and without charge, the warranty element should be considered an incidental part of the main transaction (to supply the goods) and revenue should be recognized together without the need of disaggregation. The estimated cost of providing the standard warranty should at the same time be accrued.

Questions

8. Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please provide an alternative for determining when a promised good or service is transferred.

9. The boards propose that an entity should recognize revenue only when a performance obligation has been satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide some examples.

Response

In response to Question 8, we believe that the recognition of revenue when control of an asset passes or the customer receives a service can work. However, we reiterate in our response to Question 9 our previous concerns to ensure that the staged delivery of a promised service should give rise to periodic recognition of revenue and not the delay of all the revenue to the end of the contract. Given our assumption that revenue should reflect an entity's activity as well as the satisfaction of a performance obligation and notwithstanding that the latter is being considered the driver of when the revenue is recognized, we believe it still important to observe this consideration.

We believe that the key point here is to show that a performance obligation has been satisfied even if physical possession of the asset under construction has not passed to the customer. In the case of a number of, but not all, construction contracts, the construction takes place at a dedicated site not at the customer premises. It is important that this fact alone does not preclude the recognition of revenue periodically. Physical delivery should not be the only measure of whether control has passed.

To this end, the ability to appropriately recognize revenue so that it is a reliable measure may be dependent on a well documented contract which specifically includes the necessary performance obligations. These could include milestones expressed as dates, acceptance of steps of the project or delivery and payments among others. Section 4.37 of the Discussion Paper, for example, refers to how non-returnable payments from the customer can be an indicator of performance obligations being settled and control passing so that revenue should be recognized. However, progress payments are not usually in themselves good measures of how far a performance obligation is satisfied and contracts do not always include all the detail needed to assess these key questions. Judgement will often be required by the supplier to determine when the revenue trigger has been reached and, therefore, practical guidance to help assess the passing of control will be very useful.

Questions

- 10. In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous
 - a. Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?
 - b. Do you agree that a performance obligation should be deemed onerous and measured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?
 - c. Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so,

- what characteristic of the obligations makes that approach unsuitable? Please provide examples.
- d. Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.
- 11. The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (eg selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognize these costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.
 - a. Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?
 - b. In what cases would recognizing contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.
- 12. Do you agree that the transaction price should be allocated to the performance obligations on the basis of an entity's stand-alone selling prices of the goods or services underlying these performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?
- 13. Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

Response

In respect of question 10 we agree that initial measurement should be at contract price. This would be the most simple and at the same time most logical approach.

Although we understand that a cost trigger could mean an onerous contract is first identified later than it might otherwise, we believe this is the most straightforward and easy to understand. We believe a current price trigger which includes a profit element in the calculation would give rise to numerous problems of estimating the value. We also feel it is not conceptually sound to include a planned profit in the assessment of whether a contract is onerous or not.

Question 10c again addresses the fundamental question of whether the satisfaction of performance obligations always gives decision-useful information. As we have noted previously, we believe that it can but there are certain types of contracts which have to be considered carefully to ensure the criteria to provide decision-useful information is maintained. In the examples below, the satisfaction of performance obligations by delivering the service should also reflect to a certain extent the activity of the entity delivering the service –

- long-term "construction" type contract involving significant activity away from the customer site and "delivery" to the site near the end of the project

- or in some cases not at all (remote operation), such as system-build contracts in the IT industry;
- professional services where the only visible output is the end report, eg an audit;
- conditional sales where some of the sold goods (or services) can be returned to the entity so that the exact full value of the revenue will only be known when all customer options have expired.

As far as question 10d is concerned about the possibility of using more than one measurement approach, we believe that the primary aim should be to have just one form of measurement. As we have said, we believe that the satisfaction of performance obligations can be used successfully as long as sufficient guidance is available to allow the recognition of revenue throughout the life of the contract as the elements of it are delivered.

In response to question 11 we agree that pre-contract costs should be expensed. Any allocation of such costs to the contract value will introduce an unnecessary complication to the calculations. Although we understand the concept that such costs are linked to the contract, sales and marketing costs are generally treated as overheads and this approach should continue.

In question 12 it is important to be able to disaggregate the different elements of a delivery whether this involves goods or services or both. We believe that this segmentation of contracts into multiple deliverables is one already well established and we believe this will work. However, we also believe that the standard should also consider cases where the value of a "bundle" of goods and services is in fact significantly more than the value of them on a stand-alone basis. There is a need for guidance on how to allocate the "added value" which the deliverer of the services is providing.

The estimation of a stand-alone price is envisaged in question 13 for cases where an entity does not sell the good or service separately. It is difficult to see what other option would be available. However, we believe that estimations such as these introduce a speculative element into the financial statements which could undermine their validity. If it is too difficult to come up with a separate value because the elements are not sold separately, we should consider not disaggregating at all.

As noted before, we believe that if a standard warranty is supplied at the time of sale of goods to all customers and without charge, the warranty element should be considered an incidental part of the main transaction. It follows, therefore, that no estimation of a separate value for warranty is necessary and no disaggregation into the supply of the goods and of the standard warranty should be made.

Yours faithfully.

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