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Mr. Henry Rees
Senior Project Manager
International Accounting Standards Board
First Floor
30 Cannon Street
London, EC4M 6XH
United Kingdom

Dear Mr. Rees:

**Re: Discussion Paper Preliminary Views on**
**<u>Revenue Recognition in Contracts with Customers</u>**

We welcome the opportunity to provide our comments on IASB and FASB (boards) preliminary views on revenue recognition. We agree that existing rules under both IFRS and US GAAP are difficult to apply and sometimes result in different accounting treatment for seemingly the same economic transaction. We also recognize the difficulty in creating a consistent set of standards that could be applied to various types of revenues, since the scope of this project is so broad. However, we feel that the approach proposed in the DP will require significant efforts to implement and the boards have not yet demonstrated the significant improvement in quality of financial reporting resulting from the approach proposed in the DP. In fact, the DP notes that for many contracts, the new approach will not result in a change in reporting. Further we note that the proposed approach shifts the focus from economic substance of revenue recognition to focus on assets and liabilities and then control of those assets and liabilities. This approach is very conceptual and may be difficult to operationalize. The following comments are made assuming that the boards will wish to continue with the proposed approach.

We agree with the principle of recognizing revenue based on changes in contract net assets. We also agree that identification of performance obligations in a contract is important in recognizing revenue consistently with the economics of the transaction. However, we note that the definition of performance obligation, in its current form, is too broad to be operational and will result in large number of performance obligations identified in each contract with each performance obligation not necessarily having any economic substance. This could be solved by requiring that, in addition to being defined as a promise in a contract, they would be recognized separately only when they have value to the customer on a stand-alone basis. This could be captured in any of the following ways:

(a) narrowing the definition of a performance obligation,
(b) providing additional guidance when each performance obligation needs to be separated, or
(c) changing the criteria of when the performance obligation is satisfied.

Also, since satisfaction of performance obligations will rely on transfer of control, a definition for control needs to be provided. The definition should be applicable to both transfers of goods and services. The concept of control is difficult to understand in context of provision of services. We believe that the definition should encompass the risk and rewards of ownership for assets and completed performance for services to capture economic substance of control and not be limited to transfer of legal ownership.

Lastly, in our view the boards should finalize their work on Conceptual Framework—Phase B: Elements and Recognition prior to completing the work on revenue recognition standard. It is important to define assets and liabilities and key principles around their recognition before completing the revenue project that relies so heavily on principles behind definition of assets and liabilities.

The detailed responses to the questions in the discussion paper follow.

If you have any questions concerning our comments or suggestions, we would be pleased to discuss them.

Sincerely,

Deborah L. Crossman

**Question 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?**

*Yes, we agree with boards' proposal to recognize revenue based on increase in the contract's net position. This is consistent with fundamental definition of revenue as established in existing GAAP (IAS 18) and ensures that same principles apply to all revenue streams.*

**Question 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 those examples?**

*The focus of any scope exemptions should be on revenue type and not contract type. Since a single contract may include revenue streams that are both appropriate for the proposed model and those that are not. For example, fair value changes in the financial instruments are measured based on the exit price approach, which the boards identified as not applicable to the revenue standard (DP, par 5.17). However, interest and dividend streams relating to these financial instruments should be recognized under the proposed revenue recognition model.*

*Other areas where there is already extensive guidance on revenue recognition should not be included in the scope of the new standard to avoid potential inconsistencies. Examples of such guidance are leasing and insurance contracts.*

**Question 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.**

*We agree with the proposed definition of a contract. A definition which is consistent with legal definition of contract should be operational. We are not aware of jurisdictions or circumstances where this definition would be difficult to apply.*

**Question 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.**

*We believe that the proposed definition of a performance obligation is too broad to be operational. As noted in the discussion paper, it is easy to agree that where multiple parts are provided together at one time the accounting would be for all parts taken together (DP, par 3.23).*

*However, where multiple parts are provided individually and the number of parts is not defined, the definition becomes very difficult to apply.*

*This is particularly true for service contracts (for example, M&A advisory services) where we may provide multiple 'promises' to the client (for example, deliver market reports, provide analysis of specific acquisition targets, provide valuation services for the acquisition target, etc.), and each promise may contain multiple deliverables (for example, we may provide valuation services for one acquisition target or 20, depending on client needs). Breaking that contract into individual 'promises' is very onerous and each performance obligation provides no meaningful information, since each individual promise taken on its own has little or no value to the customer. We therefore recommend the definition of a performance obligation to include the requirement that the performance obligation has to have a stand alone value to the customer.*

**Question 5**
**Do you agree that an entity should separate the 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?**

*Similar to our response to question 4, separating performance obligations based solely on timing of when the entity transfers the promised asset to the customer may result in separate performance obligations that have little or no economic substance. This is particularly true for cases where a 'promise' in a contract has no stand alone value to the customer. Although the seller may deliver on that 'promise', taken separately it has no value to the customer and recognizing revenue at that point does not seem consistent with economics of the transaction and therefore the performance obligation should not be separated. Our suggestion is, in addition to the timing of transfer of the promised asset to the customer, we also need to consider if the transferred asset has any stand alone selling value, and if not then, performance obligation should not be separated.*

**Question 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?**

*Yes, we agree that the right of return represents a performance obligation, since the seller provides the customer with a promise to accept returned good. The customer is likely to ascribe some value to that performance obligation and therefore to be consistent with the economics of the revenue related to that performance obligation, it should be recognized separately.*

**Question 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?**

*Sales incentives represent performance obligations, since the seller provides a customer with a promise to provide a discounted product in the future.*

**Question 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 suggest an alternative for determining when a promised good or service is transferred.**

*Yes, we agree that satisfaction of a performance obligation should be based on control (consistent with current definition of assets). However, we urge the IASB to provide a definition of 'control', since it is not currently provided in the Framework. We believe that the definition should be based on economic substance of control (as opposed to the legal definition). We believe that the economic substance of control is that of holding risk and rewards of ownership of an asset.*

The definition of control should cover contingent control. For example, in a construction contract the company responsible for construction controls the building being constructed until it is completed, unless there is an extraordinary event that transfers the control to the customer (for example, due to fire or earthquake).

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

*Similar to our response to questions 4 and 5, the contracts for which the proposal would not provide decision-useful information are those that have performance obligations that have no stand alone value to the customer. The reason for this is that under the proposal, the entity would recognize revenue even though insignificant, or even no value has been provided to the customer, which is not consistent with the economics of the transaction.*

**Question 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?**

*Yes, we agree that the performance obligation should be measured initially at the transaction price, since the initial transaction price is the most objective and timely measure of fair value of the transaction.*

**(b) Do you agree that a performance obligation should be deemed onerous and remeasured 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?**

*Yes, we agree that the entity should remeasure the performance obligation if it is deemed onerous. We also agree that those performance obligations where the expected cost of satisfying them is in excess of transaction price (carrying amount of the obligation) should be deemed onerous. We support remeasurement when the transaction is deemed onerous since the expectation of a loss is information that is highly relevant to users of the financial statements.*

**(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.**

*No, we believe the proposed approach provides the most decision-useful information.*

**(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.**

*The answer depends on how the scope of the final standard is defined. We generally believe that measurement of fair value changes of financial instruments should be done in accordance with the guidance in IAS 39. Therefore, if the remeasurement of financial instruments is scoped out of the proposed standard, then no other measurement methodologies are required.*

*Generally, we believe that where revenue is covered by another standard, the revenue recognition standard should scope it out (such as leasing, insurance, etc.) since these and other contracts are already addressed by other IFRS standards and could require different measurement methodology.*

**Question 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 recognise those 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?**

*The treatment should differ if obtaining the contract will meet the definition of a performance obligation. If there is a contract where a customer agrees to make a payment to the vendor to reimburse the vendor's selling costs to the customer, then this could be considered a performance obligation and therefore, revenue should be recognized when that performance obligation is met (e.g. when the conditions for reimbursement are met). In all other scenarios, we* *agree that the amount charged to the customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligation since it represents a portion of regular profit margin on the transaction.*

**(b) In what cases would recognising 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.**

*We think that the recognition of origination costs as expenses when incurred provides the most decision-useful information, unless they meet definition of an asset based on other standards.*

**Question 12**
**Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?**

*For products and services that are unique to a particular transaction (i.e. they are not sold on stand-alone basis, by either the company or other competitors) it may create significant operational difficulty to have to estimate stand-alone selling price for each performance obligation. For example, a consulting firm or construction company may create unique products for a specific customer. A requirement to have to estimate selling prices for each of the performance obligations in each unique contract would be burdensome.*

*As an alternative to selling prices, allocation of the transaction price could be permitted on a reasonable and consistent basis for similar arrangements. This allows the entity greater room to apply judgment and use available data to allocate transaction price without having to estimate stand alone selling prices.*

**Question 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?**

*Use of estimates is accepted elsewhere in IFRS and US GAAP and should not be constrained for this area of accounting.*