

1 August 2010

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

Dear Sir or Madam,

Comments on Exposure Draft *Revenue from Contracts with Customers*

I appreciate the opportunity to comment on the exposure draft *Revenue from Contracts with Customers* and I hope that my comments will be of assistance in the further deliberation. Please note that the views expressed herein are solely my own, and do not reflect those of any other individual or organisation.

General comments

I do support the main principles of the proposed revenue model. I believe that the proposed model provides a robust framework for addressing revenue accounting issues.

However, I recommend that the boards set out requirements for the presentation of revenue, because it seems that there are not such requirements in the presentation section.

I believe that paragraphs 64-66 of the presentation section are, in effect, requirements for the recognition of contract assets and contract liabilities, or receivables. The boards should set out overall requirements for the recognition and measurement of contract assets and contract liabilities, separately and explicitly. In addition, I believe that when neither party to a contract has performed, the entity should not recognise a receivable, a contract asset or a contract liability.

And I do not agree with the requirement for the reconciliation of the contract balances, because such disclosure would not clarify the relationship between the revenue recognised in the period and the financial position. Therefore, I would propose the following requirement instead:

“An entity shall disclose:

- (a) the amount of revenue recognised concurrently with the payment;

- (b) the amount of revenue recognised prior to the payment; and
- (c) the amount of revenue recognised subsequently to the payment.”

I firmly believe that this disclosure would provide simple and more relevant information.

Responses to the specific questions

Question 1: Paragraphs 12-19 propose a principle (price interdependence) to help an entity determine whether:

- (a) to combine two or more contracts and account for them as a single contract;***
- (b) to segment a single contract and account for it as two or more contracts; and***
- (c) to account for a contract modification as a separate contract or as part of the original contract.***

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

I agree with the proposed principle.

And I agree with that an entity should recognise the cumulative effect of a contract modification in the period in which the modification occurs. However, it should be described explicitly that the revenue may be negative amount in rare cases.

Question 2: The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct.

Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

I agree with the proposed principle.

Question 3: Do you think that the proposed guidance in paragraphs 25-31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

I basically think that the proposed guidance and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer.

However, I recommend that the boards amend the description of *unconditional* in paragraph 30(a) as follows: “An obligation to pay is unconditional when the customer can require nothing of the entity”. Similarly, the description of *unconditional* in paragraph 66 should be amended as follows: “A right to consideration is unconditional when the entity is required nothing by the customer”. This is because I believe that the right or obligation is not unconditional if the entity has a corresponding performance obligation.

As for quality assurance warranties, particularly in the case of product recalls, it should be more clarified that because any part of goods is generally distinct, remaining performance obligations are obligations to transfer the defective parts of the goods, not obligations to transfer the whole goods.

And I am concerned that the description of quality assurance warranties in paragraphs B13-B16 and the description of customer acceptance clauses in paragraphs B69-B73 may result in different accounting outcomes, despite the similarity of such transactions. I recommend that the boards reconcile the description of quality assurance warranties with the description of customer acceptance clauses, if the boards intend to require the same accounting.

In addition, I recommend that the boards illustrate how an accounting firm should account for revenue from audit services (which may be provided on a time-charge basis), because it would be a good example to better understand the proposed model.

Question 4: The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

I agree with that an entity should recognise revenue on the basis of an estimated transaction price. And I also agree with the proposed criteria that an entity should meet to be able to reasonably estimate the transaction price.

Question 5: Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?

I agree with that the customer's credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation. And I also support the expected loss approach proposed in the exposure draft *Financial Instruments: Amortised Cost and Impairment*.

However, I prefer that, as a practical expedient, when the customer's credit risk is not material, an entity reflects the customer's credit risk not in the determination of the transaction price, but in the subsequent measurement of the receivable at the end of each reporting period. Under this method, an entity recognises a day 1 loss, if the receivable is recognised at the end of the period. This method is almost the same as the practice in Japan. I believe that when the customer's credit risk is not material, the adjustment of revenue would not necessarily provide decision-useful information.

Question 6: Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

I agree with that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component.

Question 7: Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

I agree that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price of the good or service underlying each of those performance obligations.

When I considered the discussion paper *Preliminary Views on Revenue Recognition in Contracts with Customers*, I thought that it might be preferable to avoid that an entity recognises a contract loss

for a separate obligation when the contract as a whole remains profitable. However, I was persuaded by the boards' explanation described in paragraphs BC136-BC137. Therefore, I agree with the requirements for allocating the transaction price and applying the onerous test.

Question 8: Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards, an entity should recognise an asset only if those costs meet specified criteria.

Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?

I think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient. However, it is to be noted that I believe that such requirements are important and necessary for the faithful presentation of financial performance.

Question 9: Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

I agree with the costs specified.

Question 10: The objective of the boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

I think many of the proposed disclosure requirements will meet the objective that is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

However, I think some of the proposed disclosure requirements are not sufficient or not appropriate.

I do not agree with the requirement for the reconciliation of the contract balances. I believe that such disclosure would not clarify the relationship between the revenue recognised in the period and the

financial position. This is because, in many cases, the balance of contract assets is nil. And the balance of contract liabilities would be not so material. In my view, many users are more concerned with the relationship between the revenue and the receivables than the reconciliation of the contract balances. Therefore, I would propose the following requirement instead:

“An entity shall disclose:

- (a) the amount of revenue recognised concurrently with the payment;
- (b) the amount of revenue recognised prior to the payment; and
- (c) the amount of revenue recognised subsequently to the payment.”

I firmly believe that this disclosure would provide simple and more relevant information.

I believe that the disclosure of the timing when the entity typically satisfies its performance obligations required by paragraph 77(b) would provide decision-useful information to users. Moreover, it is important to disclose the reasons why the entity adopts that timing in accordance with the proposed revenue model. Therefore, the boards should require the disclosure of the reasons why the entity adopts that timing of the satisfaction of performance obligations, in addition to the timing itself.

And I agree with that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year. However, I believe that an entity should also disclose the amount of revenue from the contracts which were disclosed in accordance with paragraph 78 in the previous period, because such information would enable users to compare the actual results with the previous estimates.

Question 11: The boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

As noted in my response to Question 10, I agree with the proposed disclosure requirement.

However, I believe that an entity should also disclose the amount of revenue from the contracts which were disclosed in accordance with paragraph 78 in the previous period, because such information would enable users to compare the actual results with the previous estimates.

Question 12: Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

I agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

Question 13: Do you agree that an entity should apply the proposed requirements retrospectively? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

I agree that an entity should apply the proposed requirements retrospectively.

Question 14: The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

I think that the application guidance is not necessarily sufficient or not necessarily appropriate to make the proposals operational.

As for Scenario 1 of Example 2 in paragraph B3, I do not believe that it should be presumed that the price for the third year of service is equal to the price per year for the extension periods, because the entity has taken the risk of the original contract like a forward contract.

As for Example 3 in paragraph B12 and Example 14 in paragraph B52, it is difficult to understand what kind of asset the right to recover products is. Therefore, the boards should set out overall requirements on the accounting for rights to recover products, separately and explicitly.

As for Scenario 2 of Example 29 in paragraph B91, I believe that recognising both a contract liability and a receivable simultaneously is inconsistent with the definition of a contract liability set out in Appendix A, the recognition criteria of a contract liability set out in paragraph 64 and the guidance on the recognition of financial assets provided in paragraph AG35 of IAS 39.

A contract liability is defined as an entity's obligation to transfer goods or services to a customer for

which the entity has received consideration from the customer. However, the entity has yet to receive the consideration in the example.

According to paragraph 64, an entity should present the contract as either a contract asset or a contract liability when either party has performed. However, both the entity and the customer have not performed yet.

According to paragraph AG35(b) of IAS 39, assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognised until at least one of the parties has performed under the agreement. In my view, *generally* means “unless the firm commitment to buy or sell non-financial items is within the scope of IAS 39”. And, both the entity and the customer have not performed yet.

I believe that when neither party to a contract has performed, the entity should not recognise a receivable, a contract asset or a contract liability.

As noted in my response to Question 3, as for quality assurance warranties, particularly in the case of product recalls, it should be more clarified that because any part of goods is generally distinct, remaining performance obligations are obligations to transfer the defective parts of the goods, not obligations to transfer the whole goods. And I recommend that the boards reconcile the description of quality assurance warranties in paragraphs B13-B16 with the description of customer acceptance clauses in paragraphs B69-B73, if the boards intend to require the same accounting. In addition, I recommend that the boards illustrate how an accounting firm should account for revenue from audit services (which may be provided on a time-charge basis), because it would be a good example to better understand the proposed model.

Question 15: The boards propose that an entity should distinguish between the following types of product warranties:

- (a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.***
- (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.***

Do you agree with the proposed distinction between the types of product warranties? Do you agree

with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

I agree with the proposed distinction between the types of product warranties. And I agree with the proposed accounting for each type of product warranty.

However, as noted in my responses to Question 3 and Question 14, as for quality assurance warranties, particularly in the case of product recalls, it should be more clarified that because any part of goods is generally distinct, remaining performance obligations are obligations to transfer the defective parts of the goods, not obligations to transfer the whole goods. And I recommend that the boards reconcile the description of quality assurance warranties in paragraphs B13-B16 with the description of customer acceptance clauses in paragraphs B69-B73, if the boards intend to require the same accounting.

Question 16: The boards propose the following if a licence is not considered to be a sale of intellectual property:

- (a) if an entity grants a customer an exclusive licence to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the licence; and***
- (b) if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer the licence and it satisfies that obligation when the customer is able to use and benefit from the licence.***

Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

I agree that the pattern of revenue recognition should depend on whether the licence is exclusive. And I also agree with the patterns of revenue recognition proposed by the boards. I believe that granting an exclusive licence to use the entity's intellectual property is similar to a lease, and granting a non-exclusive licence to use the entity's intellectual property is similar to a sale of a product containing that intellectual property.

Question 17: The boards propose that in accounting for the gain or loss on the sale of some non-financial assets, an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

I agree with that in accounting for the gain or loss on the sale of some non-financial assets, an entity should apply the recognition and measurement principles of the proposed revenue model.

Other items

As for the presentation of revenue

It seems that there are no requirements for the presentation of revenue, although this [draft] standard is a standard on revenue. Therefore, I recommend that the boards set out requirements for the presentation of revenue, even if an entity presents revenue as a single line item in the statement of comprehensive income. If the boards intend to require that an entity disaggregates revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors in the statement of comprehensive income, the requirement in paragraph 74 should be provided in the presentation section.

As for contract assets and contract liabilities

I believe that paragraphs 64-66 are, in effect, requirements for the recognition of contract assets and contract liabilities, or receivables. And those requirements should not be included in the presentation section. Therefore, I recommend that the boards set out overall requirements for the recognition and measurement of contract assets and contract liabilities, separately and explicitly.

In addition, as noted in my response to Question 14, I believe that when neither party to a contract has performed, the entity should not recognise a receivable, a contract asset or a contract liability.

As for goods or services transferred continuously

I recommend that the boards amend existing asset standards to ensure that the customer recognises goods or services transferred continuously as assets or expenses in the period when the entity recognises the revenue.

Yours faithfully,

Hidekazu Sasaki, CPA (Japan)