

Comment Dutch Accounting Standards Board (DASB)

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

Our ref : AdK
Date : Amsterdam, 21 October 2010
Direct dial : Tel.: (+31) 20 301 0391 / Fax: (+31) 20 301 0302
Re : Comment on Exposure Draft Revenue from Contracts with Customers

Dear members of the International Accounting Standards Board,

The Dutch Accounting Standards Board (DASB) appreciates the opportunity to respond on the Exposure Draft (ED) Revenue from Contracts with Customers.

Below we summarize our main concerns regarding the ED and provide you with a summary of our comments on the most important issues. In the appendix we have included our detailed comments on all of the questions.

EFRAG has issued a draft comment letter with a summary of their main comments. In this letter we will refer to some of that comments by means of reference to 'EFRAGs' views'.

We do not support the approach of developing a new standard on revenue recognition. We agree with EFRAGs' views that the ED has been issued without a thorough conceptual debate of what revenue should represent. Without a proper understanding of what revenue should represent it is difficult or maybe even impossible to develop a clear model with unambiguous principles for revenue recognition. The present ED underlines this, unfortunately.

Moreover, without such a conceptual debate we are not convinced of the necessity to develop a new standard on revenue recognition. Although we acknowledge that there are some contradictions in IAS 18 and 11 and that there might be some practical application issues in applying IAS 18 and IAS 11, mainly regarding multiple element accounting, we believe that those issues can be resolved by improving these standards. Therefore, as long as the necessity for a new standard has not been underpinned by a conceptual debate, we believe that efforts at improving accounting for revenue should be directed at improving IAS 18 and IAS 11 themselves.

In case the IASB nevertheless decides to continue to develop a new standard, we agree with EFRAG not to support the model proposed in the ED. In that situation we concur with an activity-based model as proposed in EFRAGs' draft comment letter.

We emphasize that our answers to the specific questions in the ED are solely for the case that the IASB will issue a standard in accordance with the principles of the ED and should not be interpreted as support for those proposals. For that case, our comments can be summarised as follows:

- We agree with EFRAG that some principles, even when considering the respective guidance, are unclear in how to apply in practice. In particular the principles and guidance regarding price interdependence for combining and segmenting contracts (Q1) and determination when control has been transferred (Q3). In our opinion, any standard should be based on principles that are crystal clear and - where this is not the case - any vagueness of a principle should not be compensated by additional guidance;
- With EFRAG, we disagree that the business practice of any other entity should be considered for determining whether a good or service is distinct (Q2).
- We concur with EFRAG that variable revenue should be recognized only if and when, in addition to conditions set in paragraph 38 of the ED, variable revenue is measured for a large population of contracts (Q4). In addition to that, we believe that for single contracts variable revenue from a satisfied performance obligation should be recognized if the transaction price can be reasonably estimated according to the principle of 'best estimate';
- We do not agree with a general principle to reflect the customer's credit risk in revenue (Q5) and to adjust for the time value of money (Q6). In our opinion applying these principles should be restricted to industries and business-models where these elements are explicitly calculated in the transaction price. Furthermore the IASB should consider these proposals in relation with the Financial Instruments project;
- We do not support a model in which losses are recognised in an overall profitable contract. Therefore, the transaction price should not be allocated to all separate performance obligations in proportion to the stand-alone selling prices (Q7 and Q9). In our opinion allocation in proportion to the stand-alone gross margins would be a better solution. Such a method would lead to a proportionate allocation of the total gross margin with the result that in an overall profitable contract all performance obligations will be profitable;
- We consider it an accounting mismatch to expense necessary costs that are directly related to obtaining the contract (and that will be recovered through the contract) in one period and account for the related revenue in a later period (Q8). That mismatch should be resolved.
- We do not agree with the proposed disclosures (Q10, Q11 and Q12). They are too extensive. Although we could agree with the objectives of the requirements, we think the requirements should be presented as possible disclosures that might be relevant in a particular situation. The proposed disclosures regarding remaining performance obligations and disaggregation are too extensive. Information about remaining performance obligations should be part of Management Commentary. Disaggregation of revenue is part of segment reporting;
- We do not agree to distinguish two types of product warranties (Q15) based on coverage for latent defects and coverage for faults that arise after delivery. In our opinion, distinction should be made based on whether or not the warranty is sold separately;
- With regard to revenue recognition for licences (Q16), we do not agree with the proposed distinction based on exclusivity. The IASB is in favour of Alternative 2 as

described in EFRAGs' draft comment letter. In that alternative the factor to be considered is whether continuous involvement exists.

Of course we would be happy to discuss our reaction with you.

Yours sincerely,

A handwritten signature in black ink, consisting of a vertical line on the left, a loop at the bottom left, and a long horizontal stroke that curves upwards at the right end.

Appendix: answers DASB to the specific questions

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General remark: we do not agree to develop a new standard. We emphasize that our answers to the specific questions in the ED are solely for the case that the IASB will issue a standard in accordance with the principles of the ED and should not be interpreted as support for those proposals.

Recognition of revenue (paragraphs 8—33)

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?

Response DASB: We do not agree with the proposed principle. We agree with EFRAG that the principle of price interdependence for combining and segmenting contracts, even when considering the proposed guidance, is unclear in how to apply in practice. In our opinion, any standard should be based on principles that are crystal clear and - where this is not the case - any vagueness of a principle should not be compensated by additional guidance

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?

Response DASB: We disagree that the business practice of any other entity should be considered for determining whether a good or service is distinct. We agree with EFRAGs' views.

IASB 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?

Response DASB: No, we agree with EFRAG that the principle regarding determination when control has been transferred, even when considering the proposed guidance, is unclear in how to apply in practice. In our opinion, any standard should be based on principles that are crystal clear and - where this is not the case - any vagueness of a principle should not be compensated by additional guidance. We agree with EFRAGs' views.

Measurement of revenue (paragraphs 34—53)

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 recognizing revenue when the transaction price is variable and why?

Response DASB: We do not agree entirely that an entity should recognise revenue on the basis of the expected value of the transaction price. We concur with EFRAG that variable revenue should be recognized only if and when, in addition to conditions set in paragraph 38 of the ED, variable revenue is measured at expected value for a large population of contracts. In addition to that, we believe that for single contracts variable revenue from a satisfied performance obligation should be recognized if the transaction price can be reasonably estimated according to the principle of ‘best estimate’.

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?

Response DASB: We do not agree with a general principle to reflect the customer’s credit risk in revenue. In our opinion applying this principle should be restricted to industries and business-models where credit risk is explicitly calculated in the transaction price, like for example in some mail-order businesses. Furthermore the IASB should consider this proposal in relation with the Financial Instruments project.

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?

Response DASB: We do not agree with a general principle to adjust for the time value of money. In our opinion applying this principle should be restricted to industries and business-models where interest is explicitly calculated in the transaction price. Furthermore the IASB should consider this proposal in relation with the Financial Instruments project.

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?

Response DASB: We do not agree with the proposed allocation method. In our opinion allocation in proportion to the stand-alone selling prices will not always lead to decision useful information. The proposed model could lead to recognition of losses for ‘onerous’ performance obligations being part of an overall profitable contract in which prices of goods and services are interdependent. We do not support a model in which losses are recognised in an overall profitable contract. Therefore, the transaction price should not be allocated to all separate performance obligations in proportion to the stand-alone selling prices. In our opinion allocation in proportion to the stand-alone gross margins would be a better solution. Such a method would lead to a proportionate allocation of the total gross margin with the result that in an overall profitable contract all performance obligations will be profitable, and with the result that the allocation faithfully depicts the different margins that may apply to the separate performance obligations.

On the issue of changes after the initial allocation we concur with EFRAGs’ views.

Contract costs (paragraphs 57—63)

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 (for example, IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38 Intangible Assets or ASC Topic 985 on software), 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?

Response DASB: We do not agree with the proposal. We agree with EFRAG that costs of securing and obtaining a contract should not always be expensed when incurred but might be capitalised, if certain conditions are met. We consider it an accounting mismatch to expense necessary costs that are directly related to obtaining the contract and that will be recovered through the contract in one period and account for the related revenue in a later period. That mismatch should be resolved.

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?

Response DASB: We do not agree with the proposal. We agree with EFRAGs' views.

Disclosure (paragraphs 69—83)

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?

Response DASB: We do not agree with the proposal. Although we could agree with the objectives of the requirements, we are concerned that the extensive requirements of paragraphs 73 to 80 will be regarded as a 'minimum list' and could result in a large amount of insignificant detailed information, despite the 'materiality threshold' as described in paragraph 70 of the ED. Therefore we think the requirements of paragraphs 73 to 80 should be part of the Application Guidance and should be presented as possible disclosures that might be relevant in a particular situation to meet the objectives of paragraph 69.

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?

Response DASB: We do not agree with the proposed disclosures that in our opinion are too extensive. We acknowledge that information about the orders in hand can be relevant to predict future revenues and future cash-flows, but we do not believe that information about contracts with an original duration expected to exceed one year only is decision-useful information. Information about the total of expected future revenues and cash-flows would be more relevant. We believe such information should not be part of the disclosures in the financial statements, but should be part of Management commentary.

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?

Response DASB: We do not agree with the proposal. Disaggregation of revenue is part of segment reporting (IFRS 8).

Effective date and transition (paragraphs 84 and 85)

Question 13: Do you agree that an entity should apply the proposed requirements retrospectively (ie as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? 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.

Response DASB: *Note: we do not agree to develop a new standard. Our answer to this question is solely for the case that the IASB will issue a standard in accordance with the principles of the ED.*

In that case we agree that the proposed requirements should be applied retrospectively, however a relative long implementation period should be taken into account. To be able to apply a new standard some entities will have to adjust their financial information systems, specifically in cases where a new standard will lead to more unbundling, and /or will lead to a different timing or a different amount of revenue recognition. We think that at least two full reporting periods between the date of issuance of the standard and the effective date are necessary. (For example, if the standard is issued in 2011, the effective date should be for reporting periods starting after December 31, 2013. Entities would then have reasonable time for preparation to be able to apply the requirements of the standard to contracts as of 2013 (which would then be the basis for the comparative figures in the first financial statements (2014) under the new standard)).

Application guidance (paragraphs B1—B96)

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?

Response DASB: In general we think that where the standard is unclear this should be addressed by clarifying the principles rather than by way of application guidance. We agree with EFRAGs' views, although we think application guidance can lead to rather rules-based interpretations of the standard. In order to avoid that, we believe application guidance should be limited to a very minimum.

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?

Response DASB: We do not agree to distinguish two types of product warranties based on coverage for latent defects and coverage for faults that arise after delivery. In our opinion, distinction should be made based on whether or not the warranty is sold separately.

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?

Response DASB: We do not agree with the proposed distinction based on exclusivity. We are in favour of the model described by EFRAG as Alternative 2 in paragraphs 121 to 123 of their draft comment letter. In that model the factor to be considered is whether continuous involvement exists.

Consequential amendments

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

Response DASB: We do not agree to develop a new standard. Our answer to this question is solely for the case that the IASB will issue a standard in accordance with the principles of the ED. In that case we agree with the proposal and with EFRAG.

Additional issues

DASB concurs with the views of EFRAG on the additional comments in relation to the definition of stand-alone selling price and the distinction between a contract asset and a receivable as described in Appendix 2 of EFRAGs' draft comment letter.