

STAFF PAPER

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FASB | IASB Meeting

Project	Revenue recognition		
Paper topic	Feedback summary from comment letters and outreach		
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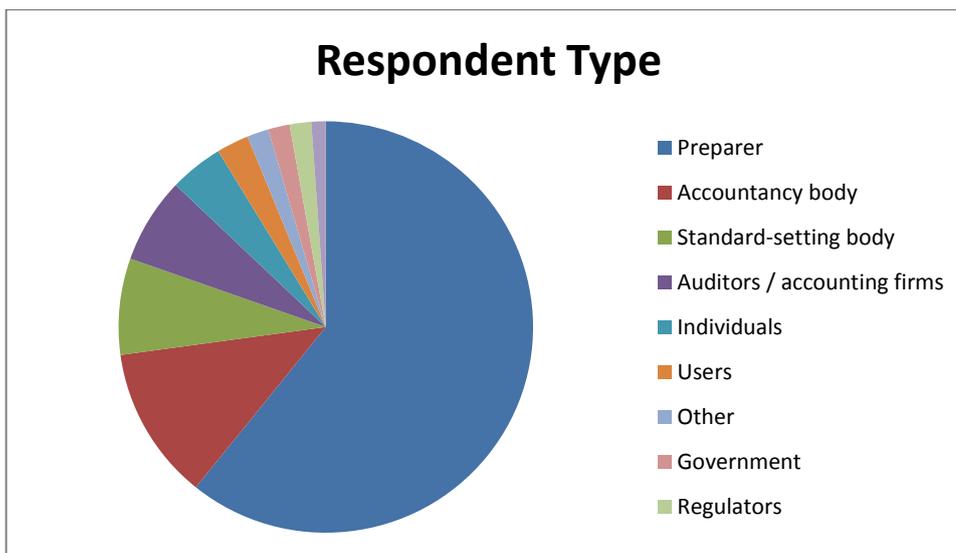
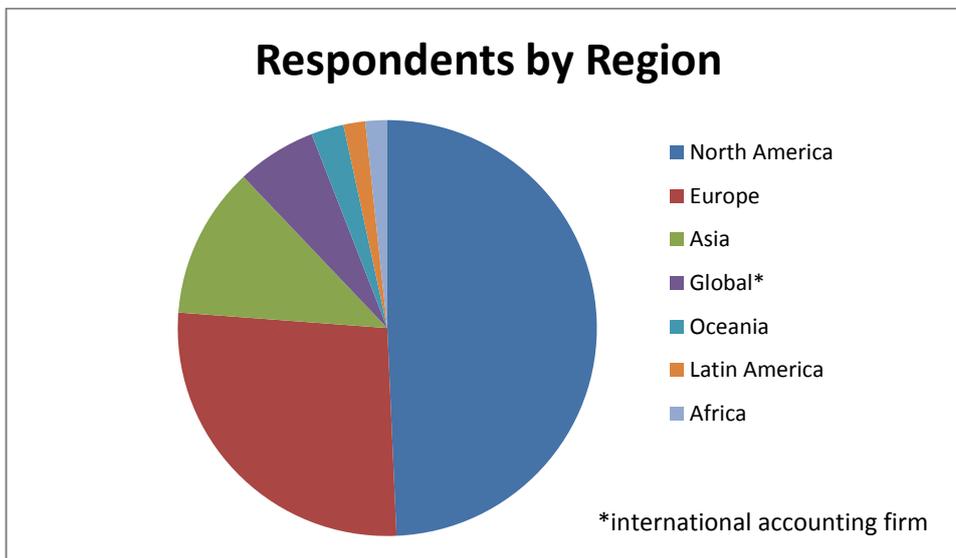
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Purpose of this paper

1. This paper provides a summary of the feedback received in response to the Boards' revised exposure draft *Revenue from Contracts with Customers*, published in November 2011. This summary focuses on the main issues identified in the staff's preliminary analysis of the comment letters received to date, as well as those raised in feedback received from the outreach activities undertaken on the proposals by the staff and Board members. (Agenda Paper 7B/160B provides a summary of those outreach activities.) A detailed analysis of any feedback received will be presented to the Boards when the redeliberations on those issues commence. This paper should be read in conjunction with Agenda paper 7C/160C, which outlines a proposed plan for the redeliberations.
2. [FASB only] To the extent necessary, the staff will provide a supplemental paper to this memo to include any additional feedback in the comment letters from, and outreach with, non-public entities and their users.
3. This paper does not include any staff recommendations and the Boards will not be asked to make any technical decisions at this meeting.

Overview of comment letters

4. The four-month comment period for the exposure draft ended on 13 March 2012. Initially, the Boards received a number of requests to extend the deadline because, in parts of the world, a portion of the comment period coincided with the year-end reporting cycle. Although the deadline was not extended, to the extent that it was possible, feedback received after the deadline (but prior to the posting of this paper) is reflected in this summary.
5. At the time of writing, the Boards have received 357 comment letters. Those letters are summarised below by type of respondent and geographic region:



6. The number of comment letters received on the exposure draft was significantly less than the almost 1,000 comment letters that were received on the June 2010 exposure draft. One of the main reasons for this decrease in the number of letters is because many of those in the construction industry, who accounted for almost 500 of the comment letters received in 2010, felt that the Boards addressed their concerns related to identifying separate performance obligations and the addition of criteria for determining performance obligations that satisfied over time. In addition, many of the concerns of the non-public entities in the construction industry were alleviated by a more active engagement with the FASB.
7. Many of the comment letters on the 2011 exposure draft are also significantly shorter than those received on the 2010 exposure draft. The main reason for this is because the Boards did not seek specific comments on all matters in the exposure draft, but rather invited comments on only six specific issues, as well as the broader issue of whether the proposed requirements are clear and can be applied in a way that effectively communicates to users of financial statements the economic substance of an entity's contracts with customers.
8. Two other factors may also explain the reduction in number and length of the comment letters. First, many respondents appear to be comfortable with the overall model and its principles and, therefore, their comments are focused on a small number of specific issues or questions. Those issues or questions highlighted areas where respondents thought it may be difficult to implement the proposals or where they thought the accounting proposed would not faithfully depict the economics of their transactions and therefore some questioned whether that accounting was intended by the Boards.
9. Secondly, many, like those in the construction industry, indicated that the Boards adequately addressed their concerns that were raised on the 2010 exposure draft.

Overall feedback

10. Almost all respondents welcomed the Boards' decision to re-expose the proposals and compliment the Boards and staff on their extensive outreach. Respondents

also acknowledge the Boards' responsiveness to the comments on the June 2010 exposure draft which they think has led to significant improvements in the exposure draft, including the addition of the criteria for determining when a performance obligation is satisfied over time, the removal of the requirement to consider credit risk as part of the transaction price and simplifying the application guidance related to warranties and licenses.

11. Most of the respondents and participants in outreach meetings also indicated support for the revenue project generally and the overall objective of a single revenue model that can be applied across industries and transactions. However, almost all respondents in the telco industry have raised concerns about the usefulness and practicality of applying the proposed model. Primarily their concerns relate to the proposed allocation methodology and cost requirements. Those concerns are outlined in paragraphs 132– 146.
12. Users also indicated support for the other objectives of the revenue project, which are to remove inconsistencies in existing revenue requirements, improve comparability across entities, industries, jurisdictions and capital markets, and provide more useful information through improved disclosures. One user indicated that:

...we believe the Proposed Standard will be an improvement over existing standards and provide better financial information for users—as long as it is consistently applied, accompanied by adequate disclosure and audit enforcement of its principles. (CL #275)

Control

13. Many users and preparers broadly support the principles of the model where revenue is recognised based on the transfer of control of goods or services. However some thought that, in addition to assessing the transfer of control, some transactions (eg when there is significant seller financing) may require an additional assessment as to whether risks (or risks and rewards) have been transferred. In those cases, users also requested the Boards to consider whether it

was appropriate to include a collectibility threshold in the revenue model (see paragraph 66). Absent those additions to the model, users thought that additional disclosures about those transactions would be necessary.

14. A small number of respondents disagree with the proposed transfer of control model, in part because they do not believe there is adequate justification for a model based on the transfer of control. They, as well as those who agreed with a transfer of control model, request the Boards develop a common definition of control for the conceptual framework before issuing a revenue standard based on the transfer of control.
15. Some of those who questioned the transfer of control model also query the case for change because in their view existing standards are adequate. These respondents typically were IFRS preparers and in their view, existing revenue standards in IFRSs (IAS 11, *Construction Contracts* and IAS 18, *Revenue*) could have been improved with limited scope amendments.

Implementation challenges

16. A minority of respondents explained that the proposals were complex and not easily understood. As a result, some respondents requested further ‘field-testing’ be completed prior to finalising the standard. Other respondents requested that the Boards create implementation working groups to facilitate consistent application of the final standard and to address implementation questions as they arise. In their view, implementation working groups would be necessary to provide guidance and education for a new standard that introduces a different framework for recognising revenue for contracts with customers.
17. Other respondents also commented that the Boards should provide additional examples or application guidance to facilitate the implementation of the final standard. In some cases these requests related to a specific issue or industry. A few respondents also suggested the Boards consider whether the removal of some existing guidance should be accompanied with additional application guidance for the model.

Detailed comments

18. Despite their overall support for the project and the model, many respondents provided detailed comments on the questions asked by the Boards in the exposure draft. Respondents also provided detailed comments on other parts of the model often as a result of trying to apply the proposals to their contracts. Broadly, those comments identify some parts of the model where respondents thought that the principles should be refined or clarified and other parts of the model that they thought were practically difficult to apply. Furthermore, some of their comments identify parts of the model that respondents disagree with the effect of its application.

Structure of the paper

19. The feedback of the main issues raised in both the comment letters and outreach are grouped into the following categories. Those categories and the issues outlined below correspond to the proposed plan for the redeliberations (Agenda paper 7C/160C):
- (a) core issues that could affect the framework for the recognition and measurement of revenue;
 - (b) other core proposals in the exposure draft; and
 - (c) discrete issues that affect only some types of transactions or industries.
20. Those main issues are outlined below as follows:
- (a) core issues that could affect the framework for the recognition and measurement of revenue:
 - (i) Performance obligations satisfied over time (paragraphs 21-37) and Measures of progress (paragraphs 38-43)
 - (ii) Identifying separate performance obligations (paragraphs 44-49)
 - (iii) Constraining the cumulative amount of revenue recognised (paragraphs 50-63)

- (iv) Accounting for customer credit risk (paragraphs 64-73)
- (v) Time value of money (paragraphs 74-79)
- (b) other core proposals in the exposure draft:
 - (i) Onerous performance obligations (paragraphs 80-90)
 - (ii) Interim and annual disclosures (paragraphs 91-104)
 - (iii) Transition (paragraphs 105-111)
- (c) discrete issues that affect only some types of transactions of industries:
 - (i) Scope of the proposals (paragraphs 112-117)
 - (ii) Contract issues (paragraphs 118-131)
 - (iii) Allocation of the transaction price (paragraphs 132-143)
 - (iv) Contract acquisition costs (paragraphs 144-146)
 - (v) Licenses (paragraphs 147-152)
 - (vi) Other specific comments (paragraph 153-154)
 - (vii) Consequential amendments (paragraphs 155-165)
 - 1. Transfers of non-financial assets (paragraphs 155-158)
 - 2. Other consequential amendments (paragraphs 159-165)

Core issues - recognition and measurement of revenue

Performance obligations satisfied over time

21. The exposure draft includes criteria (in paragraph 35) for determining when a performance obligation is satisfied over time. Those criteria specify that a performance obligation is satisfied over time and thus revenue can be recognised over time if either:
- (a) The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or

(b) The entity's performance does not create an asset with alternative use and at least one of the following criteria are met:

- (i) The customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs.
- (ii) Another entity would not need to substantially re-perform the work the entity has completed to date if that other entity were to fulfil the remaining obligation to the customer without the benefit of any asset that is presently controlled by the entity.
- (iii) The entity has a right to payment for performance completed to date and it expects to fulfil the contract as promised.

22. In response to question 1 of the exposure draft, most respondents supported the addition of the criteria for determining when a performance obligation is satisfied over time and, thus, when revenue can be recognised over time because they provide guidance on how to assess whether the customer obtains control of a service. Most respondents also broadly supported the thinking underlying the criteria. However, a few respondents thought the criteria in paragraph 35 of the exposure draft might result in revenue recognition over time in some circumstances where it was not appropriate to recognise revenue over time because control does not transfer to the customer over time. This is because in their view, the criteria in paragraph 35 (for determining when revenue can be recognised over time) may be met in circumstances where control does not transfer over time, for example in the production of some inventory items (this is discussed further in paragraph 27). In addition, some respondents highlight that the reference in BC91 to AICPA Statement of Position 81-1 *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* might be interpreted to mean that 'all contracts previously accounted for using a percentage-of-completion approach under US GAAP would automatically qualify for revenue recognition under paragraph 35(a)' (CL #77). In light of that possible interpretation, those respondents suggested the Boards emphasise that the criteria

for determining when revenue can be recognised over time (paragraph 35) are based on the transfer of control rather than an activities model.

23. In addition to those comments, most respondents also observed that paragraph 35 is complex and in some cases difficult to apply, especially to contracts beyond the construction and production of tangible goods. In their view, some of this complexity results from duplication or overlap in the criteria or concepts that require greater explanation. Those respondents noted that a helpful explanation was often included in the basis for conclusions; however they suggest that some of those explanations be brought forward to the body of the standard. Some respondents suggested that to simplify the application of the proposals, the Boards should exclude contracts that are completed in less than 12 months from the criteria in paragraph 35 (ie so that those contracts would be accounted for as performance obligations satisfied at a point in time).
24. Respondents also suggested the following refinements and clarification of the paragraph 35 criteria as follows:
- (a) Including stronger linkage between the concept of transfer of control and the criteria in paragraph 35;
 - (b) refining the definition and application of the concept of ‘alternative use’;
 - (c) clarifying the application of the criteria in paragraph 35(b)(ii), that is, ‘another entity’ would not need to substantially re-perform the work completed to date’; and
 - (d) clarifying the determination of the existence of a ‘right to payment’ (in paragraph 35(b)(iii)).

Linking the concept of transfer control to the criteria in paragraph 35

25. Some respondents observed that it was not clear that the criteria in paragraph 35 (to determine if a performance obligation is satisfied over time) were developed to help apply the concept of transfer of control of services. Respondents thought it was unclear how the notions of ‘alternative use’ (paragraph 35(b)), ‘another entity

would not need to re-perform’ (paragraph 35(b)(ii)) and in particular a ‘right to payment for performance completed to date’ (paragraph 35(b)(iii)) link to the control principle in paragraph 32 in the exposure draft. Many respondents suggested ways in which they thought the principles in paragraph 35 could be expanded more clearly and in a way that more obviously makes the link with paragraph 32.

Definition and application of alternative use

26. Many respondents agreed with the notion of ‘alternative use’ (paragraph 35(b)) for determining when a performance obligation is satisfied over time. However some explained that it was not an easy notion to understand, in part because the notion of ‘alternative use’ is defined more broadly in the proposals than some would intuitively understand it to mean. This is because paragraph 36 indicates that entities must also consider contractual restrictions that limit the entity’s ability to readily direct the promised asset to another customer, rather than simply the practical usefulness of the asset outside of the contract. Some other respondents have also highlighted it may be difficult to clearly translate the notion of an asset having no ‘alternative use’ to the entity.
27. Respondents who highlighted that ‘alternative use’ may be a difficult notion to understand also explained that elements of the description of ‘alternative use’ in paragraph 36 may not be interpreted correctly. Those respondents were specifically referring to the requirement that ‘an entity shall consider at contract inception the effects of contractual and practical limitations on the entity’s ability to readily direct the promised asset to another customer’ and that an ‘asset would not have an alternative use if the contract has substantive terms that preclude the entity from directing the asset to another customer’. Those respondents were concerned that those elements of the definition of ‘alternative use’ could include inventory items that an entity may be explicitly (and contractually) prohibited to transfer to another customer. Thus in circumstances where the customer has made a non-refundable payment in full for the item and the contract specifies that the customer is entitled to a specific item that can be identified, for example, by a serial number and the fact that it is the first manufactured item of a new product,

the proposals as drafted may enable an entity to conclude that they could recognise revenue as the item is manufactured. Those respondents commented that in those cases, the criterion of no ‘alternative use’ should not be met.

28. One respondent highlighted that the broad interpretation of ‘alternative use’ as described in the previous paragraph may occur because the meaning of the term ‘substantive’ is unclear. They suggest the Boards clarify that there needs to be a substantive reason for the contractual restriction on transfer.
29. A few respondents also requested the Boards provide guidance on how to address circumstances when the assessment of whether an asset has ‘alternative use’ changes throughout the life of the contract.
30. A small number of respondents also questioned whether ‘alternative use’ was a necessary criterion for all of the sub-criteria listed in paragraph 35(b), in particular the criteria in paragraph 35(b)(i) (ie when the customer simultaneously receives and consumes the benefits of an entity’s performance). This is because in cases where that criterion is relevant, an asset that is immediately consumed cannot have alternative use. Others have highlighted that it is difficult to apply the notion of alternative use to situations contemplated by paragraph 35(b)(i) because, as explained in the basis, it may not be clear that any asset is created by the entity’s performance. For similar reasons, those respondents also questioned whether ‘alternative use’ was necessary for the criterion in paragraph 35(b)(ii).

Applying the criterion in paragraph 35(b)(ii)

31. As explained above, respondents observed duplication within paragraph 35, but many explained that the most obvious duplication was paragraph 35(b)(ii) (ie another entity would not need to substantially re-perform the work the entity has completed to date if that other entity were to fulfil the remaining obligation to the customer without the benefit of any asset that is presently controlled by the entity). This is because, in their view, the situations captured by paragraph 35(b)(ii), (for example, a transportation service as explained in BC97), could be captured by the criteria in paragraph 35(b)(i). Therefore they consider paragraph 35(b)(ii) to be application guidance for paragraph 35(b)(i). One respondent

explains that this duplication leads to complexity in reading and applying paragraph 35, even though they ‘understood that the intent is to assist readers in finding at least one of the scenarios which clearly speaks to their fact pattern’ (CL #163).

32. Other respondents explained that they were confused as to whether paragraph 35(b)(ii) could apply to construction contracts. In their view, it is clear in the case of construction contracts that ‘another entity would not need to substantially re-perform the work completed to date’ because the incoming contractor would not need to re-build whatever had been completed to date. However many questioned the necessity of, or were confused by, the relevance of the remainder of the criterion in paragraph 35(b)(ii) that: ‘the entity shall presume that another entity fulfilling the remainder of the contract would not have the benefit of any asset...presently controlled by the entity’. In particular, some questioned whether, in assessing who has the benefit of the asset, they could consider the likely result of the legal proceedings that may occur in the event of termination or bankruptcy by the original constructor.

Determining the existence to a ‘right to payment’

33. Many respondents agreed that, in determining whether a performance obligation is satisfied over time, if the asset created does not have alternative use, it would be appropriate to also consider whether the entity has a right to payment for performance completed to date (criterion in paragraph 35(b)(iii)). However, as noted above, some respondents were unclear as to how the criterion of a ‘right to payment’ would be consistent with the objective of determining when control transfers.
34. Some respondents in the residential real estate industry particularly supported the addition of this criterion because they thought it would assist them in assessing whether revenue could be recognised over time for sales of residential units in a multi-unit apartment block that are currently within the scope of IFRIC 15 *Agreements for the Construction of Real Estate*. Other respondents in this industry explained that although they were able to conclude that their performance does

not create an asset with alternative use, they were unable to meet the criterion in paragraph 35(b)(iii); that is, they could not conclude that they had a right to payment for performance to date. This would mean that they would only be able to recognise revenue at a point in time for the sales of their units, which in their view would not be an appropriate depiction of their performance.

35. Many respondents raised questions about the meaning of the term ‘right to payment’. Many questioned whether a ‘right to payment’ meant that milestone or stage payments would be required to be made. Other respondents also questioned whether the payment terms need to be specified in the contract or whether they should also consider general business practices and/or the legal environment in which the contract was signed. Furthermore, respondents asked for guidance on how the entity should assess if a payment corresponds directly to performance. In particular, respondents in the residential real estate industry questioned how they would assess performance in the construction of a multi-level apartment block, when the building of one unit depends on the units below, or when a significant portion of the cost is related to the land, which in some cases may transfer to the customer upon signing the contract.
36. Some respondents also questioned whether, in the event of termination, it would be appropriate to require an entity to obtain compensation that ‘approximates the selling price of the goods or services transferred to date’ to be able to meet the criterion of ‘right to payment’ in paragraph 35(b)(iii). This is because the selling price or compensation that would be obtained on termination of an incomplete contract may not necessarily be the compensation that would be received if the contract was completed as expected. Respondents suggested that, in the case of contract termination, it should be sufficient to consider that an entity has a ‘right to payment’ if they are compensated for their costs plus a reasonable profit margin, even though that profit margin may be less than what they would receive if the contract was completed as expected.
37. One respondent thought that the criterion for right to payment should be elevated to an overarching criterion that was necessary for all performance obligations satisfied over time and at a point in time. That respondent disagreed with the

Boards' rationale in paragraph BC103 for not including a 'right to payment' as an overarching criterion. In contrast, a few respondents expressed concern that the application of this criterion may lead to a revenue recognition pattern that appears to be driven by the timing of cash payments made. In their view, recognising revenue based on the timing of the cash payments made may not be consistent with the principle of measuring progress towards the complete satisfaction of a performance obligation.

Measures of Progress

38. When a performance obligation is satisfied over time, 'an entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation' (paragraph 38 of the exposure draft). The objective of measuring progress is to depict the transfer of control of goods or services to the customer over time. The Boards did not ask a question on the proposals related to measuring progress, however a small number of respondents raised questions or comments on this topic.
39. Some respondents raised questions that were specific to their industry. In particular, some respondents in the aerospace and defence industry requested more guidance on whether it would be appropriate to use a units of delivery method to measure progress in a production contract that is accounted for as a single performance obligation satisfied over time. In their view, the units of delivery method best depicts the transfer of goods or services to the customer for their contracts because even though they have met the criteria in paragraph 35 and concluded that control transfers over time, the delivery of each unit is accepted by the customer. Those respondents also request the Boards include additional guidance related to how production costs would be recognised in measuring their progress using a units of delivery method. In their view, it would be more appropriate to recognise their costs on the basis of an average cost per unit, which is currently required by ASC Subtopic 605-35 *Revenue Recognition – Construction-Type and Production-Type Contracts*. Those respondents also highlighted that it would be particularly important to maintain the cost guidance in

ASC Subtopic 605-35 if the production of each good in their production contracts is determined to be a separate performance obligation, as opposed to a single performance obligation (see discussion of identifying separate performance obligations in paragraph 48). This is because, in their view, the separate performance obligations in a single contract are interrelated and thus costs should be accumulated under the contract and equally allocated to each separate performance obligation on an average cost per unit basis.

40. Other respondents raised comments about measuring progress that may have broader implications beyond their own industry. For example, some respondents questioned how an entity would measure progress for a stand-ready obligation. A few respondents in the software industry indicated that this was particularly relevant for post-contract support services (PCS) which sometimes includes unspecified when-and-if-available software upgrades. Those respondents regarded their obligation to provide those upgrades to be a stand-ready obligation that ‘equally exists on every day of the period’ (CL #307). Those respondents requested the Boards to clarify that, in those cases, the most appropriate measure of progress for a stand-ready obligation would be to recognise revenue rateably over the period of the obligation rather than on the basis of when those software upgrades are actually provided.

Applying the input method

41. The exposure draft explains that appropriate methods for measuring progress include both input and output methods. The exposure draft also includes specific guidance on the application of an input method when there are inefficiencies in the entity’s performance (ie the proposals in paragraph 45 of the exposure draft on wasted materials) and when the customer obtains control of goods significantly before the related services (ie the proposals in paragraph 46 of the exposure draft on uninstalled materials). Some respondents questioned the need for this specific guidance and raised concerns about its application.
42. Some respondents highlighted that there were some challenges in applying guidance in paragraph 45, which would require an entity to exclude the costs of

wasted materials, labour or other resources in measuring progress towards complete satisfaction of a performance obligation. In particular, as one respondent explained ‘it is unclear how one determines if a cost represents waste or inefficiency when the concept of rework is priced into a company’s bids across a portfolio of contracts with the knowledge that rework will vary from contract to contract’ (CL #49). Other respondents highlight that the requirement to exclude costs of wasted materials would add complexity because they would need to track some costs separately, which would also mean a change in practice for them because they currently consider those costs in calculating changes in the profit margin on the project.

43. Some respondents also disagreed with the guidance in paragraph 46 of the exposure draft. That paragraph can limit the amount of revenue that is recognised to the cost of the goods transferred if the customer obtains the control of those goods significantly before the services related to those goods are performed (ie uninstalled materials). Specifically, those respondents disagreed with the outcome outlined in Example 8 in the exposure draft that indicates that when applying paragraph 46, a profit margin of zero is recognised on the transfer of the ‘uninstalled materials’ to the customer. In their view, recognising different profit margins for different parts of a single performance obligation is inconsistent with the objective of identifying separate performance obligations. Furthermore, one respondent highlighted that, in their view, applying paragraph 46 as outlined in Example 8, would be misleading for contracts where a significant portion of the costs relates to work performed by sub-suppliers. This is because it may result in the recognising a significant portion of the profit margin on a small proportion of the costs incurred.

Identifying separate performance obligations

44. The Boards did not ask a question on identifying separate performance obligations. However, many respondents acknowledged the Boards’ improvements to the criteria for identifying separate performance obligations (paragraphs 28 and 29 in the exposure draft). In particular, those respondents

supported the principle of identifying separate performance obligations on the basis of distinct goods or services. However, many expressed difficulty in applying the criteria to their contracts. A minority of respondents suggested that this may be because the paragraphs appear to be too rules based and focus too much on the customer's perspective.

45. Others queried whether the criteria in paragraph 29 were written to apply only to construction contracts. Paragraph 29 requires an entity to bundle goods or services, whether or not they are distinct, when (a) those goods or services are highly interrelated and transferring them to the customer requires that the entity also provide a significant service of integrating the goods or services into the combined items and (b) the bundle of goods or services is significantly modified or customised. Many also requested clarification about the various terms in paragraph 29, that is, 'highly interrelated', 'significant service of integration' and 'significantly modified or customised'. To minimise these practical difficulties, one respondent suggested that a better approach for determining when performance obligations should be bundled may be to 'set out the underlying principle, together with indicators of when it may become applicable' (CL #75).
46. Some specifically highlighted the difficulty in applying paragraph 29(b) (ie the bundle of goods or services is significantly modified or customised), because even in a construction contract it is difficult to see how the raw materials (eg bricks) are modified or customised to create the end product. Other industries, such as software, highlighted difficulties in determining *how much* modification or customisation would be considered 'significant' particularly in cases where the contract requires basic software plus customisation services. Furthermore, they questioned whether the fact that another entity could provide a similar customisation service meant that the criterion in paragraph 29(b) would not be met. Those respondents suggested the boards incorporate some of the guidance from ASC Subtopic 985-605-25 *Software - Recognition* that distinguishes separate elements based on whether or not they are essential to other elements in the transaction. Other respondents also suggested that paragraph 29(b) seems unnecessary, because it is difficult to identify transactions that would be

inappropriately identified as a bundle by paragraph 29(a) and yet excluded by paragraph 29(b).

47. Some respondents also indicated that they found it difficult to apply the criteria in paragraphs 28 and 29 to the bundle of services related to providing software referred to as post-contract support (PCS), that often includes a package of items such as telephone support, bug fixes and unspecified when-and-if-available upgrades. This is because each part of these arrangements are often sold separately (paragraph 28(a)) to different customers and thus each part may be considered to be distinct. Furthermore, it may often be difficult to conclude that the bundled post-contract support services are ‘highly interrelated’ or that they represent ‘a significant service of integration’ or ‘customisation’, even though the amount of each service in the bundle may be closely related to performance under the other services (ie the amount of telephone support might increase or decrease depending on the amount of bug fixes or when-an-if-available upgrades to the software). Those respondents acknowledge that they may be able to apply the practical expedient in paragraph 30 (ie two or more distinct goods or services may be accounted for as a single performance obligation) to these services. However, they would also need more guidance as whether the boards think that these services have the same pattern of transfer and further how they may be able to measure progress for these services as explained in paragraph 40.

Repetitive service and similar specialised items

48. Many respondents highlighted that it was difficult to apply the criteria in paragraphs 28 and 29 to contracts that provide repetitive services delivered consecutively and also to the production of similar specialised items. In particular, respondents explained that it was unclear whether these items would be considered to be a bundle of distinct goods or services (ie a single performance obligation) or whether they would be many distinct goods or services and thus many separate performance obligations. Examples of such transactions include the daily provision of electricity or gas over a defined period of time or the building of 50 specialised aircraft (for a single customer).

49. Respondents also observed that the difficulty in applying paragraphs 28 and 29 to these types of goods or services is further complicated when considering the interaction of the practical expedient in paragraph 30 (ie two or more distinct goods or services may be accounted for as a single performance obligation, if they have the same pattern of transfer). For example, if the consecutive delivery of units of electricity are determined to be many separate performance obligations, should those separate performance obligations be accounted for as a single performance obligation under paragraph 30? Respondents observed that determining whether the contract includes one or many performance obligations and whether the practical expedient in paragraph 30 should apply has implications on other parts of the proposals such as contract modifications (see paragraph 126), the allocation principle, the onerous test and the disclosure of remaining performance obligations. Other respondents also requested clarification as to whether the practical expedient can be applied to achieve a different accounting result than if the performance obligations were accounted for separately.

Constraining the cumulative amount of revenue recognised

50. Question 3 in the exposure draft asks respondents whether they agree with the proposal to constrain revenue recognition when the amount of consideration is variable. The constraint limits the cumulative amount of revenue that can be recognised to the amount to which the entity is reasonably assured to be entitled. Some respondents raised questions about what type of amounts the Boards would consider to be ‘variable’. Those respondents highlighted inconsistent interpretations of the guidance in paragraph 53 of the exposure draft that provides a list of what would be considered to be variable consideration (ie ‘discounts, rebates, refunds, credits, incentives, performance bonuses, penalties, contingencies, price concessions or other similar items’). In particular, some respondents explained that many interpret the term ‘contingencies’ to be limited to consideration that is dependent on events outside of the control of the entity (to be consistent with the IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* definition of contingent assets), even though that did not appear to be what

the Boards intended. Those respondents requested the Boards to clarify both the definition of variable consideration and the meaning of the term ‘contingencies’ as it relates to variable consideration.

51. Most respondents agreed in principle with the need for a constraint in the revenue model, and many broadly agreed with the principles proposed to apply the constraint (that is, when the entity has predictive experience). However many respondents still have concerns related to the application of the constraint. One respondent stated that:

Although we believe that the Boards have made a significant improvement by placing an overall constraint on revenue to that which is reasonably assured, we believe further restrictions should exist related to the recognition of variable consideration.(CL #154)

52. Some respondents in the asset management industry disagree with the result achieved by applying the constraint to some performance-based fees (eg carried interest) because in their view, it does not represent the economics of their transactions. This is because the application of the constraint would appear to result in revenue not being recognised until all of the uncertainty (which is due to market risk) in those fees is resolved. Most often, this uncertainty will only be resolved after several years. In addition, these respondents highlight that it represents a change in practice in the accounting for these fees because currently, the majority of the industry is recognising those fees at the amount that the manager would be entitled to receive if the contract was terminated on that date (*‘Method 2’ in Codification Topic 605-20-S99 SEC Staff Announcement: Accounting for Management Fees Based on a Formula*).

53. Other respondents raised concerns about:
- (a) use of the term ‘reasonably assured’
 - (b) determining what is ‘predictive experience’,
 - (c) the inclusion and scope of the example in paragraph 85, and

- (d) the interaction of the constraint with measurement of the transaction price.

Use of the term ‘reasonably assured’

54. Although they broadly agree with the principle of a constraint on the cumulative amount of revenue recognised, many respondents commented on the confusion caused by the use of the term ‘reasonably assured’. Those respondents observed that the term is used elsewhere in IFRSs, US GAAP and auditing requirements, and further noted that the meaning is often different than the qualitative assessment the Boards intended in the exposure draft. Respondents suggested that the Boards either re-draft the section to avoid the use of any term or select another term that is not used elsewhere in accounting requirements. A few others suggested that instead of replacing the term, the Boards should provide a more robust definition that can be applied consistently.
55. Some users explained that in addition to the ambiguity over the term ‘reasonably assured’, the judgements required in determining when an entity’s experience is predictive (paragraph 82 of the exposure draft) may create diversity in practice. Those users also requested more disclosure around the application of the constraint including the estimates and judgements used in applying the constraint.

Determining what is ‘predictive experience’

56. Many respondents supported the criteria in paragraph 81 in the exposure draft for determining when an entity is reasonably assured to be entitled to an amount (that is, the entity has experience and that experience is predictive). However, some respondents suggested that the term ‘predictive experience’ was too vague and could be loosely interpreted. In particular, respondents have highlighted that some may conclude that their historical experience is ‘predictive’ and thus revenue may be recognised, even ‘when factors exist that could cause significant changes in the [amount of] variable consideration’ (CL #248). Some respondents from the software and technology industries explain that the conclusion that historical experience is ‘predictive’ in these cases may require the recognition of revenue for variable consideration when they sell products to a distributor (ie ‘sell-in’),

instead of when those products are sold through to the end customer (ie ‘sell-through’). In their view, revenue recognition when products are sold to a distributor would be inappropriate, because often there is significant uncertainty about the amount to which the entity will ultimately be entitled at the time the products are sold to the distributor. Typically, that uncertainty is minimised only upon the sale to the end customer. If revenue is recognised before the sale to the end customer, respondents highlight that significant subsequent adjustments to revenue may be required.

57. Those respondents suggest that to eliminate the risk that some may interpret historical experience is ‘predictive’ when factors exist that may cause significant change, the Boards should establish clearer guidance for how an entity would determine whether its experience is predictive. Other respondents suggest that to address this issue and the difficulty with the term ‘reasonably assured’, the Boards should establish a clear minimum threshold for when variable consideration should be recognised as revenue. Some respondents suggested a threshold of ‘probable’, however a few acknowledged that a ‘probable’ threshold can mean different things in different jurisdictions.
58. Some users also requested that the Boards establish a threshold (eg probable) for determining when an entity is ‘reasonably assured’ to be entitled to an amount of variable consideration. Often, those respondents also suggest that the Boards establish a collectibility threshold for revenue recognition that would apply to both fixed and variable consideration (see paragraph 66).

Inclusion and scope of the example in paragraph 85

59. Respondents also broadly agree with the indicators in paragraph 82 in the exposure draft that provide guidance for when an entity’s experience may not be predictive of the amount of consideration to which an entity is entitled. Some respondents however disagreed with including paragraph 85 in the exposure draft that constrains the amount of revenue recognised when an entity licences intellectual property to the amount of the customer’s subsequent sales. Those respondents agree with the outcome, however they suggest that paragraph 85 is

too rules based and should be addressed by clarifying the principles in paragraph 81-82. Alternatively one respondent suggests that paragraph 85 should be redrafted to include a general principle that would permit revenue recognition only in circumstances where the customer cannot avoid the liability.

60. Many respondents also suggested that if the Boards retain a specific exemption from recognising some types of variable consideration, the scope of the example in paragraph 85 (ie sales-based royalties on intellectual property) should be expanded to include other transactions with similar economic circumstances such as sales-based arrangements that do not result from a license of intellectual property or a royalty arrangement based on a production.
61. Contrary to those views, a small number of respondents, primarily in the pharmaceutical, software and technology industries, appreciated the clarity that paragraph 85 provided them in accounting for their licenses of intellectual property.

Interaction with the measurement of the transaction price

62. Some respondents have highlighted the complexity in applying a two-step process of estimating the transaction price that may then be constrained when revenue is recognised. In addition, some have indicated that they perceive an inconsistency with the ‘most likely’ method for estimating the transaction price and the assessment of whether the entity is reasonably assured to be entitled to the amounts. Some acknowledge that this inconsistency is in part due to ambiguity over the unit of account for the constraint – that is, does it apply at the performance obligation level, contract level or a portfolio level, for example:

Assume the entity (i) selects the most likely amount method as its accounting policy; and (ii) has relevant experience that it has, say, an 80% likelihood of success. The most likely amount method would seem to result in recognition of 100% of potential revenue, before considering the constraint. It is then unclear whether the constraint is applied at a portfolio level and limits the revenue to 80%, or whether the entity's relevant

experience implies that the constraint does not apply.

(CL #186)

63. Other respondents have observed that applying the constraint to performance obligations satisfied over time when consideration is both fixed and variable could be interpreted to result in a profile of revenue and profit recognition that does not necessarily reflect the entity's performance. This is because an entity would measure its progress towards the satisfaction of the performance obligation using a transaction price that includes both the fixed consideration and an estimate of the variable consideration; however the entity would then be required to constrain the cumulative amount of revenue recognised. This can result in the amount of revenue recognised hitting a ceiling so that no more revenue is recognised, despite the entity's performance, until the uncertainty is resolved.

Accounting for customer credit risk (collectibility)

64. Question 2 in the exposure draft requests feedback about the Boards' proposal to present customer credit risk as a separate line item adjacent to revenue in an entity's financial statements. Those proposals represent a change from the 2010 exposure draft which required entities to include the effect of customer credit risk in determining the transaction price.
65. Almost all respondents agree with the proposal to exclude the effect of customer credit risk from the transaction price. A small number of respondents also agreed with the proposal to present customer credit risk adjacent to revenue. Some of those respondents were users and regulators who indicated that they thought the proposed guidance would yield more transparent information with which they can assess the quality of an entity's earnings. One user explained:

...we strongly support these proposals to disaggregate credit risk from the transaction price, and believe that this is the most significant positive advance in the revised ED.

(CL #329)

A threshold for collectibility

66. Other users and regulators and some other respondents explain that they support the proposal to present the effects of customer credit risk adjacent to revenue. However those respondents further explained that, in their view, it was also necessary to add a collectibility threshold that must be passed before revenue can be recognised. These respondents think that revenue should be recognised only for amounts where there is a reasonably high likelihood of collection (eg probable).
67. The addition of a collectibility threshold was raised by some users as an alternative to their suggestion in paragraph 13 to require an additional assessment of the transfer of risks. In their view, a collectibility threshold would address their concerns related to the amount of revenue that may be recognised for transactions where they believe risks have not adequately transferred to the customer, when for example, there is significant seller-based financing.
68. One user acknowledged the Boards' intention (explained in BC34) to include an implicit collectibility threshold with the requirement in paragraph 14(b) (that is, in order for a contract to exist, the customer must be committed to perform (ie pay) under the contract). However, this respondent commented that such a constraint would not be effective in all situations because the wording is vague and because entities seldom enter into arrangements where they do not believe they will be able to collect.

Disagreement with proposed presentation

69. Many other respondents disagreed with the proposal to present customer credit risk adjacent to revenue. Most often, these respondents disagree because they believe that the proximity of the effect of customer credit risk to the revenue line item would inappropriately imply that the entirety of the impairment expense relates to revenue recognised in the current period. In fact, at least a portion of each year's impairment expense most likely would relate to revenue that was recognised in prior period(s).

...we do not agree with presenting any impairment of receivables arising from contracts with customers in profit or loss as a separate line item adjacent to the revenue line item. Such a treatment implies a nexus between current period revenue and impairment losses when this may not be the case (i.e. impairment losses recognised in the current period may relate to revenue recognised in previous periods). We believe that it would be more appropriate to present impairment losses on receivables arising from contracts with customers in the same line item as all other financial asset impairment losses.

To the extent that information on the impairment of receivables arising from contracts with customers (on initial recognition and subsequently) is considered necessary, we suggest that this information would be better disclosed in a note to the financial statements. (CL #302)

70. These respondents generally proposed that expenses associated with customer credit risk should be presented as administrative expenses, and that any supplemental information should be reported in the notes to the financial statements. Another respondent suggested that entities be permitted to present revenue net of credit risk in the statement of comprehensive income, with a breakdown of the gross revenue and expense related to customer credit risk in the notes to the financial statements.
71. Other respondents disagreed with the proposals because they thought the requirement to present customer credit risk ‘adjacent to revenue’ was too vague. Those respondents requested more guidance on the presentation of these amounts, specifically:
- (a) what terminology should be used in identifying these line items (ie revenue before credit risk),
 - (b) whether it is appropriate to refer to ‘revenue’ as the amount before the adjustment for credit risk,

- (c) whether the presentation should include a ‘net revenue’ amount that is revenue less customer credit risk, and
- (d) how these amounts relate to the presentation of gross margin.

72. A few respondents also requested the Boards clarify how an entity should present ‘other revenues’ (ie revenues that do not arise from contracts with customers) in relation to the line items of ‘revenue from contracts with customers’ and customer credit risk.

Other concerns

73. Many respondents also highlighted some other concerns related to the proposals on the presentation of customer credit risk as follows:

- (a) The proposed guidance appears to be overly prescriptive and therefore directly conflicts with the principles-based nature of IAS 1, *Presentation of Financial Statements*.
- (b) Meaningful feedback cannot be provided on the proposal to present customer credit risk until the impairment phase of the financial instruments project is completed.
- (c) Many disagree with the Boards’ reasoning at BC175 that the effect of credit risk on trade receivables that have a significant financing component should be presented separately from that relating to other trade receivables.
- (d) Many believe that the proposed guidance is unclear about how to account for credit risk associated with contract assets.

Time value of money

74. Although the Boards did not specifically invite comment on their revised proposals for reflecting the time value of money in the estimate of the transaction price, many respondents nevertheless commented on this topic. In the exposure draft, the Boards clarified and refined the circumstances in which an entity should account for the effects of the time value of money arising from contracts with

customers. The 2010 exposure draft proposed that an entity should account for the effects of the time value of money if there was a significant timing difference between when payment is due to the entity and when the goods or services are transferred to the entity. In contrast, the revised proposals:

- (a) specified that a contract has a financing component if the promised amount of consideration differs from the cash selling price of the goods or services (ie the price the goods or services would have been if the customer paid cash at the time those goods or services were transferred to the customer);
- (b) clarified that an entity would need to account for the time value of money only if the contract has a financing component that is significant to the contract;
- (c) specified a non-exhaustive list of factors that might indicate whether a financing component is significant to the contract; and
- (d) added a practical expedient to exempt entities from accounting for the effects of the time value of money if the contract has an expected duration of one year or less.

75. In the comment letters and outreach, questions have been raised regarding:

- (a) identifying the circumstances in which an entity should account for the effects of the time value of money in a contract with a customer; and
- (b) the complexities and other implications associated with accounting for the time value of money in some contracts, especially long-term contracts with separate performance obligations.

When to account for the time value of money?

76. There is general agreement among respondents that there are some contracts with customers whereby accounting for the effects of the time value of money would ensure that the economics of those transactions are depicted faithfully—although sometimes that agreement is limited to supporting the conceptual rationale for accounting for the effects of the time value of money rather than requiring that

accounting in practice. However, there are other contracts whereby accounting for the time value of money is considered by many respondents to not provide a faithful depiction of the arrangement because the timing difference between when payment is due to the entity and when the goods or services are transferred to the entity arises for reasons other than financing (eg because the entity wants protection against customer credit risk, or the customer wants to secure a source of supply or to be protected from price changes).

77. Many respondents agreed with the general direction of the revised proposals, which would require an entity to account for the time value of money only if the contract has a significant financing component. However, many of those respondents requested further—and more specific—guidance on identifying whether a contract has a significant financing component because the current proposals are not sufficiently detailed to ensure that contracts with significant financing components are identified consistently. Furthermore, some respondents (including users) commented that an entity should account for the time value of money when it was obvious that the contract contained a significant financing component. Users also remarked that the qualitative information should be disclosed to explain how an entity determined that a contract had a significant financing component.

Practical expedient

78. The proposed one-year practical expedient received a mixed response. Many preparers supported the practical expedient because it would simplify compliance with the proposals. However, other constituent groups (most notably, standard setters and professional bodies) expressed concerns that the practical expedient is arbitrary, and in particular it would be inappropriate for the practical expedient to apply to contracts in high-inflation economies. Some respondents requested the Boards to clarify whether the practical expedient should also apply to situations whereby the contract term is greater than one year but the period between the transfer of a goods or service to the customer and payment by the customer for that good or service is less than one year.

Complexities and other implications of the proposal

79. Respondents also raised the following concerns with the proposal:

(a) **Complexity.** Accounting for the time value of money may be complex and costly to implement, particularly for long-term contracts or contracts with separate performance obligations whereby goods or services are transferred at various points in time and the timing and amount of cash inflows from the customer does not correspond with the transfer of those goods or services. Furthermore, it was noted that the complexity would increase if the contract includes variable consideration. Respondents suggested that the revenue standard should provide additional examples to illustrate the accounting for time value of money for those types of contracts.

(b) **Asymmetrical reporting.** Some respondents noted the proposals might result in asymmetrical reporting of an entity's financial performance because the proposals would adjust the contract revenue for the effects of the time value of money but other standards may preclude the entity from adjusting the contract costs for the time value of money. For instance, one respondent commented:

We do not believe the broader implications of introducing time value into the revenue accounting model have been considered by the Boards. Business models that utilize implicit financing generally do so throughout the supply chain. An accounting model that discounts only revenues will distort the financial results of these business models. Therefore, we believe it is imperative that the Boards address time value holistically as opposed to revenues in isolation. (CL #5A)

(c) **Implications for performance metrics.** Some respondents commented that recognising both revenue and interest expense / interest income when a contract has a significant financing component has implications for assessing an entity's financial performance and position. For

instance, one respondent noted that accounting for the time value of money “will affect key balances and financial metrics (such as revenue, interest and margins) in a less than optimal depiction of an entity’s financial performance” (CL #61). Consequently, some respondents suggested additional disclosures about the amount of imputed interest recognised and the amount by which the revenue recognised differs from the cash expected to be received from the customer.

Other core proposals

Onerous performance obligations

80. The exposure draft proposes that entities perform an onerous test for performance obligations that are satisfied over time and over a period of time greater than one year. The proposed onerous test in the exposure draft requires an entity to recognise a liability and a corresponding expense if the lowest cost of settling the performance obligation exceeds the amount of the transaction price allocated to that performance obligation.
81. Question 4 in the exposure draft asks respondents whether they agree with the scope of the onerous test. Most respondents disagreed with the scope of the test and raised concerns with other aspects of the proposal to recognise a liability for an onerous performance obligation, including specifying the performance obligation as the unit of account for the onerous test and the measurement basis used in determining when a performance obligation is onerous. Some respondents also explained that they disagree with including an onerous test in the revenue proposals.

Disagreement with the onerous test in the revenue proposals

82. Some respondents disagree with a revenue standard including guidance to recognise liabilities related to onerous performance obligations. A few US GAAP respondents suggest that if a change is necessary to existing guidance, that change should instead be handled in a separate project that addresses liabilities in ASC

Topic 450 *Contingencies*. A few IFRS respondents explained that they thought the onerous test in IAS 37 and the guidance in IAS 2 *Inventories* provide sufficient guidance for determining when to recognise losses arising from contracts with customers. Furthermore, those respondents suggest there will be additional complexity created because the test in IAS 37 is undertaken at the contract level where the proposed onerous test is undertaken at the performance obligation level.

Unit of account

83. Nearly all respondents disagreed with undertaking the onerous test at the performance obligation level because they consider that it is economically counterintuitive to record a loss when the contract as a whole is expected to be profitable. In their view, requiring entities to record a loss on one component of a profitable contract distorts the overall economic intent of the negotiation and fails to capture how management prices and views the transaction. Respondents also noted that cost information may not be tracked at the performance obligation level and costly system changes may be needed to comply with the proposals.
84. To resolve these issues, respondents suggest conducting the test at the contract level or higher, to include economic benefits that may be obtained beyond the contract. Respondents rejected the Boards' justification that conducting the test at the contract level or higher will create additional complexity.
85. In contrast, a small number of users and preparers thought that it would be appropriate to apply the onerous test at the performance obligation level. In particular, those respondents indicated that they agree with the Boards' rationale to apply the test at the performance obligation level because it is consistent with the proposed unit of account at which an entity recognises revenue.

Scope

86. Many respondents disagreed with the scope of the proposed onerous test. In their view, limiting the application of the test to only those performance obligations satisfied over time will create arbitrary accounting differences in recognising losses for performance obligations satisfied over time and for performance obligations satisfied at a point in time. In addition, respondents commented that

there is inadequate justification for the limited scope and the exclusion of performance obligations satisfied at a point in time. A small number of users also disagreed with limiting the test to only performance obligations satisfied over time.

87. Additionally, most respondents disagree with limiting the test to performance obligations satisfied over a period of time greater than one year. Respondents acknowledge that the proposed limitation of the test attempts to facilitate the application of test by alleviating some of the cost-benefit concerns. They also acknowledge the Boards were limiting the scope of the onerous test to minimise the risk of unintended consequences by broadly aligning the proposals with IAS 11 and Topic 605-35. However, most agreed that the one-year scope limitation distorts the economics of similar transactions. To bolster this point, many respondents commented on the starkness of the distinction by noting that a loss would be recognised on a performance obligation that was, at contract inception, expected to be satisfied over a period of 13 months, however a loss would not be recognised on an equivalent performance obligation that was expected to be satisfied over 11 months. Some respondents also noted that the scope limitation could add unnecessary complexity because different systems and processes may need to be established to account for performance obligations with an expected duration of less than or greater than one year. Those respondents requested the Boards to permit an entity to apply the onerous test to performance obligations satisfied over a period of time less than one year.
88. Other respondents suggested extending the test to all performance obligations, including performance obligations satisfied at a point in time and performance obligations satisfied over a period of time less than one year. Users indicated that applying the test to all performance obligations would create greater consistency in financial reporting.

Measurement basis

89. Many respondents (preparers and others) disagree with the measurement basis for determining whether a performance obligation is onerous. (Paragraph 87

indicates that a performance obligation is onerous when the transaction price is less than the lowest cost of settling the performance obligation; that is, the lower of (a) the costs that relate directly to satisfying the performance obligation and (b) the amount that the entity would pay to exit the performance obligation.)

Respondents observe that it is impractical for an entity to exit a performance obligation without exiting the contract as a whole.

...we point out that the onerous test, in our view, is not appropriately implemented in the ReED. When applying the onerous test an entity compares the transaction price allocated to a performance obligation with the lowest cost of settling the performance obligation, i.e. the lower of the costs that relate directly to satisfying the performance obligation and the amount an entity would pay to exit the performance obligation. However, because of contractual limitations an entity typically cannot exit from a single performance obligation but only from the whole contract. That means the costs to exit a performance obligation equal the costs to exit the whole contract. Comparing these costs to the costs that relate directly to satisfying a performance obligation would be inappropriate. Additionally, the respective contract may also include profitable performance obligations from which an entity would also have to exit. If the contract as a whole is profitable it is unlikely that an entity would cancel the contract only to exit from a single onerous performance obligation. Even assuming that an entity would actually exit a profitable contract it is not clear to us whether the loss of profit in case of a termination of the contract is included in the costs to exit a performance obligation. (CL #270)

90. In addition, some users raised concerns with using the amount an entity would pay to exit a performance obligation as the basis for measurement. These responses suggest that common practice is to settle onerous performance obligations with performance, rather than a payment to exit. They recommend that an entity only

consider the costs to exit a performance obligation in determining whether a performance obligation is onerous if it actually plans to exit that performance obligation.

Interim and annual disclosures

91. Many acknowledged that current revenue disclosures are inadequate and thus one of the Boards' objectives in the revenue recognition project is to improve the disclosures related to revenue recognition and provide more useful information for users. In the light of this objective, users appreciate the work the Boards have undertaken in this area and generally support the disclosure requirements in the exposure draft.
92. Question 5 asked whether respondents agree with the Boards' proposal to amend IAS 34 *Interim Financial Reporting* and ASC Topic 270 *Interim Reporting*. Those proposed amendments specify the information that an entity should disclose about revenues and contracts with customers in its interim financial statements. In their comment letters and feedback provided in outreach meetings, most respondents chose not to limit their feedback on disclosure to just interim disclosures; rather, they commented about the proposed disclosure package in its entirety.
93. The comment letters and other outreach activities reveal a nearly-unanimous divide between preparers and users about the proposed disclosures. In general, users and regulators commented either that the level of proposed disclosures seemed appropriate or that they would benefit from an even greater level of disclosures. Preparers and other respondents (ie national standard setters, auditors, and trade organizations) on the other hand commented that the proposed disclosures were excessive, overly prescriptive, and would require disclosure of information that is not needed by management in running the business and, therefore, of questionable benefit to users. Broadly speaking, preparers oppose the proposed disclosures on the basis that they do not pass the cost-benefit test.

Annual Disclosures

94. In general, users and regulators commented that the proposed disclosures (required for annual reporting) are an improvement from current practice. However, most of these respondents commented that the proposed guidance could be enhanced further by requiring some additional disclosures about revenues and contracts with customers. These respondents explain that the proposed disclosures may appear extensive; however, they think this is more reflective of the inadequacy of current disclosure requirements than it is an indictment of the proposals.

The Board's project on revenue recognition offers for the first time comprehensive disclosures about revenue. Current required disclosures about revenues are inadequate. Not surprisingly, many companies voluntarily supply revenue data to help fill the void between current requirements and users' needs for information. The Board is sure to hear many concerns from preparers about the volume of incremental disclosure it has proposed. Indeed, the increase is significant when measured relative to today's minimal requirements. Yet, when measured against the importance of revenue-related issues to financial analysis, and the volume of data that many companies voluntarily supply, the proposals are reasonable. Generally, we find the proposals helpful, expanding disclosures in important areas. However ...enhancing the disclosures could better meet users' needs. (CL #28)

95. Users also provided more specific comments on the proposed disclosure requirements and commonly expressed support for the requirement to provide a tabular reconciliation of contract balances. One respondent stated that the proposed guidance for disaggregating revenues could be improved by explicitly stating that the sample categories listed in paragraph 115 of the exposure draft

constitute minimum requirements as opposed to examples. In addition, users thought the Boards could also improve the proposed guidance by including the following additional disclosure requirements:

- (a) an illustration of how the disaggregated information about revenues reconciles to any provided segment data;
- (b) detailed disclosures about contracts that contain significant financing components;
- (c) disclosure of information about the extent to which an entity's revenues are affected by innovation (ie products that are in a growth stage vs. those that are at other points in their lifecycle); and
- (d) disclosure of volume information about revenue transactions (eg number of units sold, number of sales returns, etc).

96. Regulators also advocated improved disclosures of revenue, however they were also mindful of the cost of compliance.
97. Preparers and other respondents expressed significant concerns with the volume of disclosures proposed in the exposure draft. In particular, they opposed the addition of the proposed disclosures on the basis that they do not appropriately balance the informational needs of users with the practical concerns of preparers. Some preparers suggest that the Boards should consider the adequacy of the proposed disclosures in light of the disclosure objectives being developed by the FASB in its disclosure framework project. Furthermore, these respondents suggest that the disclosure objective as stated in paragraph 109 of the exposure draft should be expanded upon or otherwise given more prominence so as to minimise the likelihood that the disclosure listed in the exposure draft come to be viewed as required minimum disclosures. Some respondents commented that it might be most helpful to state explicitly that the proposed disclosures should not be interpreted as minimum disclosure requirements.
98. Most preparers and other respondents believe that the benefit of the proposed disclosures to users would not outweigh the related costs to preparers. These respondents question the usefulness of some of the disclosures to users because

some of the information required by those disclosures is not used by management. Many of their concerns related to the proposed reconciliations of contract balances and the disclosures about remaining performance obligations proposed in paragraphs 117 and 119 of the exposure draft, respectively. Furthermore, respondents indicated that because they do not currently use some of the information required by the disclosures, they could gather it only by making significant and costly systems changes.

...preparers across all industries express extremely strong disagreement with the proposed disclosures because of significant additional costs for preparing them. That is, they are concerned that additional investment in accounting systems would be needed to collect data from across many consolidated entities, including small-sized ones, and to process them into auditable accounting information. This data, including the tabular reconciliation of contract assets and liabilities and the analysis of the entity's remaining performance obligations, is not currently used for any internal management purposes. They also have strong reservations about the effectiveness of the proposed items from the perspective of their usefulness to a disclosure in financial reporting as well as their benefit to internal management information. (CL #188)

99. In addition to these concerns about the overall cost-benefit of the proposed disclosures, respondents have indicated that they have practical concerns that would hinder their ability to apply the proposals. These concerns include the following:

- (a) ***Interaction with segment guidance:*** Despite the clarification provided in paragraph BC253, many respondents queried how the proposed disaggregation requirements should interact with the existing guidance in IFRS 8 *Operating Segments*, and ASC Topic 280 *Segment Reporting*. For instance, some respondents thought that the proposals appear to duplicate segment reporting guidance.

- (b) **Forward looking information:** A number of respondents voiced concerns that some of the proposed disclosures, particularly the disclosures about remaining performance obligations, would require them to disclose forward-looking information that more appropriately belongs in a section about management's discussion and analysis ('MD&A').
- (c) **Relevance of the disclosures about remaining performance obligations:** Several respondents commented that, despite the explanations provided in paragraph BC261, they thought that the proposed disclosures about remaining performance obligations might mislead users because they would be understood to represent backlog. The term 'backlog', as it is commonly understood and referred to in the MD&A, refers to all contracts the entity may have entered into but that are wholly unperformed (ie executory), whereas the proposed disclosures would also capture unsatisfied performance obligations from contracts that have been partially performed but exclude performance obligations from wholly unperformed contracts that can be cancelled without penalty.

Interim Disclosures

100. The exposure draft proposes to amend IAS 34 and ASC Topic 270 to require entities to provide all of the quantitative disclosures required by the exposure draft on an interim basis. Many have observed that this means that there will be little difference to what is required on an annual basis versus what is required on an interim basis. Thus, given their concern with preparing the annual disclosures, preparers have explained that the shortened timeframe to file their interim financial statements would limit their ability to comply with the proposed interim requirements. (For example, in some jurisdictions, the interim financial statements must be filed in as little as 40 days.) Respondents also highlighted that the proposals to require the disclosures on an interim basis further amplifies their cost-benefit concerns.

101. Preparers and other respondents also commented that specifying the proposed interim disclosures appears to conflict with the principles underlying IAS 34 and ASC Topic 270, which are that interim disclosures should provide users with explanations about significant changes in an entity's operations and/or financial condition since its previous annual financial statements. Those respondents consider that the Boards are deviating from this principle in one project while simultaneously pursuing broader disclosure objectives in the on-going FASB disclosure framework project.

We do not agree with the proposals in the ED to specify mandatory disclosures in respect of revenue in interim financial reports. It is inappropriate for the revenue Standard to amend IAS 34 and ASC 270 in such a way as to require disclosures that are not in line with the principles currently set out in those Standards. Any change to the principles for disclosure in IAS 34 and ASC 270 should be considered as a separate project and, at this stage, insufficient thought has been given to the purpose of disclosures in interim financial reports. (CL #75)

102. Most of the users' views of the proposed interim disclosure requirements are similar to their views on the annual disclosures. That is that they welcome the proposals and explain that such information is crucial to their analyses, regardless of the timing of the reported financial information.

We agree that an entity should provide each of the proposed disclosures in its interim financial statements. Financial statement users rely on both interim and annual financial statements when analyzing a company's business, financial position, and results. The relevance of revenue generated by a company and the accompanying disclosures are not confined to an annual period. In our view, apart from accounting policy information that has remained unchanged during periods subsequent to the annual reporting, interim disclosures should mirror the disclosures provided on an annual basis. (CL #275)

103. Contrary to those views, a small number of users disagree with the need to specify extensive interim disclosure requirements. These users share the views of preparers in that the principles of IAS 34 and ASC Topic 270 should guide the preparation of interim financial statements such that information is only provided in areas where there is a significant change or a need for an update.
104. One user group (CL #243) located in Japan surveyed their members, and found that approximately 65% did not think that all of the proposed disclosures should be required at interim dates. When asked to rank the relative importance at interim dates of each of disclosures, members of this user group ranked the main disclosure proposals in the following order (from most important to least important):
- (1) Disaggregation of revenue
 - (2) Information about onerous performance obligations
 - (3) Information about remaining performance obligations
 - (4) Reconciliations of contract balances and contract costs

Transition

105. The exposure draft proposes retrospective application of the guidance with specified practical expedients. Citing the importance of the revenue line item to entities' financial statements, users commented in response to the 2010 exposure draft that full retrospective transition would be preferable to any sort of prospective change. Preparers and auditors on the other hand commented in response to the previous exposure draft that retrospective transition would be impractical. In response to the 2011 exposure draft, these respondents have reiterated their views about transition either in comment letters or in outreach meetings.
106. Almost all users who responded to the exposure draft think that the guidance should be applied retrospectively, thus all periods presented in the financial statements at the date of initial application would be restated as if the proposals

had always been applied. Those users acknowledge the burden this transition method would put on preparers. However, they explain that this presentation is necessary to be able to meaningfully analyse financial data because trend information would be preserved. Users suggest that instead of providing an option of another transition method, a better approach would be to delay the effective date of the proposed guidance to give preparers more time to comply.

107. Almost all of the other respondents oppose the proposed full retrospective transition method. Many acknowledge the conceptual merit of retrospective transition, however, these respondents overwhelmingly believe that the costs required to comply with those transition requirements, even after using the practical expedients proposed in the exposure draft, would far outweigh the benefits. In particular, these respondents indicate that the costs of retrospective transition would be high, because changes to the revenue line item affect other items within the financial statements, statutory reports and income taxes.
108. One respondent, who elected to adopt Accounting Standards Update ('ASU') 2009-13, *Multiple-Deliverable Revenue Arrangements* retrospectively for the benefit of its users, provided a further explanation of how difficult its transition was and continues to be.

[We] elected retrospective application of ASU 2009-13 and ASU 2009-14 because the impact on our financial statements was significant and we believed retrospective application provided the best decision useful information to our financial statement users. Upon adoption of these standards we recognized approximately \$12 billion of revenue over the three-year period covered by the retrospective application that had been previously deferred... While the revenue adjustments resulting from our retrospective application primarily related to a homogeneous pool of transactions with similar terms and thus was significantly simpler than most companies will encounter, the effort to the Company was still significant and continues to be dealt with for the Company's financial

systems and its subsidiaries' statutory financial statements and tax returns. (CL #32)

Suggested alternatives

109. Many respondents suggest that as an alternative to full retrospective transition, the Boards should permit entities to apply the proposals prospectively (ie to contracts entered into on or after the effective date). In those cases respondents suggest that entities should be required to provide sufficient disclosures to outline the qualitative and quantitative effects of transition so that users can reconcile the pre-adoption financial statements to the post-adoption financial statements. This method would be substantially similar to that which was provided under ASU 2009-13. Furthermore, those respondents think that this approach would allow an entity to choose which application method was more appropriate for their business based on the significance of the change and an individual cost-benefit assessment. Given their experience with applying ASU 2009-13, the respondent above indicates that:

We strongly believe that companies will elect the most appropriate transition method to provide decision useful information to financial statement users in consideration of the significance to their reported results and the cost and level of effort to implement. However, if the Board is uncomfortable granting preparers transition method options, we recommend the Board expand the practical expedients to include consideration for materiality to previously reported financial results. We do not believe it is practical to require companies to expend significant resources over multiple years to retrospectively adopt the standard if the impact will not be material and thus not provide meaningful information to financial statement users. (CL #32)

110. Some other respondents proposed different alternatives to retrospective transition including:

(a) ***No restatement of completed contracts*** – This alternative would extend the practical expedient in paragraph C3(a) (in the IASB exposure draft, and paragraph 133(a) in the FASB Proposed ASU) so that none of the contracts completed before the date of initial application would be required to be restated. (Paragraphs C3(a) and 133(a) do not require restatement of contracts completed before the date of initial application if those contracts begin and end within the same annual reporting period.) Contracts that are in progress on the date of initial application could be either:

- (i) restated in the comparative periods in accordance with the proposals, or
- (ii) not restated in the comparative period, however the cumulative effect of applying the proposals would be recognised as an adjustment to retained earnings at the date of initial application.

(b) ***Exception to retrospective transition when the effect is immaterial*** – This alternative would introduce an exception to the requirement to apply the proposals retrospectively when the effect of restatement is immaterial. In such cases, respondents suggest one of the transition methods in (a) above be applied.

(c) ***Dual reporting of revenue information*** – This alternative would allow entities to report financial information under both the previous and the proposed guidance until which time they have aggregated enough data to seamlessly transition to the proposed guidance. Effectively, the entity would continue to report a revenue number for all contracts using current guidance, but they would also report a second revenue number that would include new contracts that are accounted for under the proposed guidance and old contracts that are accounted for under the old guidance.

111. Some respondents also explain that should the Boards decide to maintain the requirements to apply the guidance retrospectively, additional time will be needed

to prepare for the transition and thus the effective date should be deferred beyond 1 January 2015. Those respondents explain that they would need additional time after the publication of the final standard so that they can prepare systems that will account for transactions under the new proposals in parallel with the old systems. The additional time that respondents suggested varied from 4 to 10 years after the final standard is issued.

Discrete issues that affect only some types of transaction or industries

Scope

112. Few respondents commented on the proposed scope of the exposure draft; however, based on their responses the staff identified a few recurring themes that might warrant further consideration.
113. A small number of respondents commented on transactions that they believe are not appropriately considered in the scope paragraphs of the proposed guidance.
- (a) Contracts with a collaborator - Paragraph 10 in the exposure draft specifies that contracts where the counterparty is “a collaborator or a partner that shares with the entity the risks and benefits of developing a product to be marketed” are outside the scope of the proposed guidance.
- (i) Some respondents request greater clarification of what is a ‘collaborator’ and in particular, how it relates to the definition of a customer when what might be considered a collaboration arrangement in paragraph 10 is effectively an output of the entity’s ordinary activities. Such arrangements are common in the pharmaceutical industry, particularly in the area of product development.
- (ii) Other respondents point out that collaborations do not always have product development as their sole motivation; rather, many entities collaborate for marketing or distribution purposes. Based on paragraph 10 of the exposure draft, such agreements could be interpreted to be within the scope of the proposed guidance. This would

mean that the parties to such arrangements (ie the collaborators) could potentially recognise revenue as they provide goods or services to each other when in fact they have not fully performed until the output of the collaboration is sold to an end customer.

- (iii) Some respondents analogise these arrangements to sales-based royalty arrangements for licenses of intellectual property, for which the guidance would preclude recognition of variable consideration (ie over and above what the customer paid for the license) until which time subsequent sales are made to end customers. These respondents argue further that perhaps the entire amount of revenues between these parties (ie including the amount paid to acquire the license) should be out of scope until sales are made to end customers.

- (b) Paragraph 9(e) in the exposure draft indicates that specified non-monetary exchanges are outside the scope of the proposed guidance. Some respondents disagree on the basis that if such transactions have commercial substance they should be subject to the proposed guidance.

114. One respondent also requested greater clarity of the interaction of the revenue proposals and IFRIC 12 *Service Concession Arrangements* because it is not clear that revenue transactions within the scope of IFRIC 12 are out of the scope of the revenue proposals.

115. Some respondents also commented generally about the interaction of the proposed guidance with other projects such as the Boards' projects on leases and financial instruments. Those respondents requested greater clarity about the interaction of parts of those projects with the revenue proposals as follows:

- (a) The interaction of the impairment model in the financial instruments project for estimating credit risk on trade receivables and the presentation of credit risk adjacent to revenue. Some respondents raised specific questions about how to present credit risk in the revenue

proposals when the receivables balance includes both a loan balance and service fees.

- (b) Whether some financial service fees are within the scope of the financial instruments project or the revenue project. In addition, some respondents questioned whether items that are included in financial instruments guidance that are outside of Topic 825 should be within the scope of the revenue proposals.
- (c) The requirements for accounting for repurchase agreements, see paragraphs 116-117.

Repurchase Agreements

- 116. The proposed guidance requires that a sale with an option to repurchase an item at price lower than the purchase price should be accounted for as a lease. A few respondents commented that it would be more appropriate to compare the repurchase price with the fair value of the item for the purpose of making this determination, particularly in cases where the fair value of the item is highly susceptible to change. These respondents also commented that it is unclear how an entity should account for contracts that should be accounted for as a lease, but which are excluded from the scope of the leases proposals.
- 117. Many respondents from the automotive industry commented that they routinely enter into agreements with rental car companies whereby they agree to either repurchase such vehicles after a specified period of time or guarantee the residual value of the vehicle. In the former scenario the automaker reclaims custody of the vehicle and then sells it at auction, whereas in the latter scenario the rental car company maintains custody and remarkets the vehicle but is entitled to cash payment from the automaker. These respondents interpret that the proposed guidance would require that the former transaction (ie a repurchase) be accounted for as a lease, whereas the latter transaction would be accounted for as a sale. These respondents believe that this outcome does not reflect the economics of such transactions and would be prone to abuse.

Contract issues

Combination of Contracts

118. The exposure draft requires (in paragraph 17) that two or more contracts should be combined if they are entered into at or near the same time and with the same customer (or related parties), if one or more of the following criteria are met:
- (a) the contracts are negotiated as a package with a single commercial objective;
 - (b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
 - (c) the goods or services promised in the contracts (or some goods or services promised in the contracts) are a single performance obligation.
119. A number of respondents have indicated that the proposed guidance on contract combinations is too restrictive and appears to preclude the combination of two separate contracts with different customers, even though those contracts may be economically linked, for instance because the second contract is entered into only as a result of the first contract. This often occurs in the manufacturing industry where the manufacturer sells a good to a distributor (ie contract #1) and provides a good or service to the distributor's customer at no additional charge (ie contract #2). Such arrangements occur in industries such as the automotive industry, in which the automaker sells its cars through a dealer network, yet provides service or other incentives directly to the end customer and also in the pharmaceutical industry, in which the pharmaceutical company sells drugs through a distributor but provides an additional service of administration to the end customer. Experts in Islamic finance have also highlighted similar examples of transactions that have a single economic objective between multiple parties and multiple contracts (or promises).
120. Some respondents think that accounting for these economically linked contracts separately, as they appear to be required to do under the proposals, would misrepresent the economics of the transactions. This is because, in their view, the

individual contracts can be understood only by considering the contracts together as part of a broader arrangement. Therefore these respondents request the Boards modify the guidance on combining contracts to allow for them to account for such arrangements in the context of the broader multi-party relationship.

121. Contrary to that view, a few respondents in the automotive industry suggest that combining those contracts would misrepresent the economics of the transactions. This is because in their view, the additional service provided to the end customer represents a sales incentive, or another form of consideration payable, that should be deducted from the transaction price, rather than identified as a separate performance obligation.
122. Other respondents have observed that expanding the guidance on contract combinations to include contracts that are economically linked may require other contracts with similar economics also to be combined. This may occur, for example, in credit card rewards programmes where the credit card company has two separate contractual arrangements with the merchant and the cardholder. Specifically, the credit card company will receive fees from the merchant when the customer uses their card. As a result of this transaction, the credit card company also must provide reward (or loyalty) points to the cardholder. (Airline membership rewards programmes were highlighted as another example.) Although these contracts cannot be combined under the proposals, expanding that guidance may mean that they are combined because, in effect, they are ‘economically linked’.
123. While many respondents agree that combining the contracts with the merchants and the cardholder may result in a better depiction of the economics, one respondent highlights that approach will require additional guidance for their transactions. This is because they think that the requirement to combine those contracts may also require them to identify the loyalty points as a separate performance obligation. In their view, the loyalty points do not result in a performance obligation to the cardholder, but rather a ‘cost of sale’, ie a sales commission for generating fees from the merchant. This is because the offer of rewards (or loyalty) points to the cardholder are provided only when the

cardholder uses the credit card and are provided as a sales incentive to generate higher fees from merchants when a cardholder uses their credit card.

124. Those respondents also highlight that although they think the proposals (as they are written) would not require them to identify loyalty points as a separate performance obligation, the appropriate treatment of those points in credit card reward programmes should be clarified, even if the Boards decide not to modify the contract combination principles.

Contract Modifications

125. The exposure draft outlines specific requirements for contract modifications, which are defined as changes in the scope or price of the contract (or both). Those requirements distinguish between a contract modification that should be accounted for as (a) a separate contract, (b) a termination of the original contract and the creation of a new contract and (c) as part of the original contract on a cumulative catch-up basis.
126. Generally, respondents indicated that the proposed guidance for contract modifications is substantially improved from the 2010 exposure draft. In particular, many think that it more appropriately distinguishes between contract modifications that should be accounted for prospectively rather than with a cumulative catch-up adjustment. However, many respondents think that the guidance is complex and difficult to understand. In particular, many found the subtle distinction in paragraphs 21 and 22 between distinct goods or services and separate performance obligations to be confusing. That distinction was intended to ensure that modifications in contracts for repetitive or relatively homogeneous goods or services would be accounted for prospectively. However many understood the proposals to require more modifications to be accounted for on a cumulative catch-up basis than the Boards intended.

We disagree with the proposals on contract modifications. The guidance is extremely complex and sophisticated and, as a result, impracticable to apply. We kindly ask you to consider that the guidance is not only to be applied by

construction companies with a few major orders but also by companies operating in mass-market such as telecommunications industry with hundreds of possible modifications to consider. In addition, these modifications may vary seasonally or by region. The guidance on paragraphs 18-22 requires such fine differentiations with a significant degree of judgement that it will be impossible to be applied in practice. (CL #215)

127. A few respondents suggested that the Boards withdraw the proposal in paragraph 20 that a contract modification affecting only the transaction price should be accounted for as a change in the transaction price. The respondents noted that this essentially results in cumulative catch-up adjustments, which in some cases would be inconsistent with the accounting for other contract modifications in accordance with paragraphs 21 and 22. Furthermore, the proposal could be prone to structuring because an entity could circumvent it by including an insignificant good or service in the contract modification so that there is both a change in scope and price.
128. A few respondents also suggested that the Boards clarify the accounting for a modification to a contract that includes variable consideration and provide additional illustrative examples.

Unpriced Change Orders

129. Other respondents commented that paragraphs 18 and 19 of the exposure draft seems to indicate that revenue recognition guidance should not be applied, and therefore the transaction price should not be updated, until both parties to a contract have at least approved the scope of a modification. Respondents from the professional services, construction, and aerospace and defence industries commented that they routinely process modifications to the scope and price prior to them being approved.
130. An entity typically would process an unpriced change order so as not to slow progress on a large project while awaiting approval for a comparatively minor change. These respondents do not believe it is appropriate to delay recognition

for unpriced change orders in all circumstances; rather, they believe that the contract price should be updated so long as they conclude that the likelihood of approval is probable.

131. These respondents commented that the proposed guidance seems to preclude this treatment because in their case neither the scope nor the price is approved at the time of the modification. Some therefore suggested that the guidance should be modified to incorporate some of the language from Topic 605-35, that would provide further guidance for entities as to when the transaction price could be updated before the modification that is expected to approved is formally approved.

Allocating the Transaction Price

132. The 2010 and 2011 exposure drafts propose that an entity should allocate the transaction price on the basis of relative stand-alone selling prices of the promised goods or services and that an entity should estimate a stand-alone selling price if a price is not directly observable. The 2011 exposure draft amended those proposals to:
- (a) specifically permit an entity to estimate a stand-alone selling price using a residual approach if the price of the good or service is highly variable or uncertain; and
 - (b) require a discount, contingent amount or a change in the transaction price to be allocated to only some of the promised goods or services if specified criteria are met.
133. The main areas of comment on these proposals included:
- (a) requests for further guidance and clarification on the allocation of the transaction price for particular types of arrangements;
 - (b) suggested improvements to the proposal for allocating a discount to only one, or some, performance obligations in the contract; and

- (c) disagreement with the proposed basis for allocating the transaction price—this was a view that has been expressed by almost all entities from the telecommunications industry that either submitted at a comment letter or participated in outreach.

134. These comments are discussed further in the paragraphs below.

Need for further guidance and clarification on allocation

135. Further clarification on the determination of stand-alone selling prices was requested on:

- (a) the selection of a stand-alone selling price if the estimate is a range of prices; and
- (b) the determination of stand-alone selling prices of standardised goods or services that transfer to the customer repeatedly over the contract term (eg supply of commodities or repetitive service contracts). For instance, in a fixed price contract, could an entity use one stand-alone selling price to allocate the transaction price even though the price of the good or service transferred on day one could be different from the price of the same good or service that will be transferred in the future? The answer to this question has implications for the practical expedient proposed in paragraph 30 of the exposure draft (as noted in paragraph 49 above) because the exposure draft specifies that an entity can account for two or more distinct goods or services as a single performance obligation if those goods or services would have the same pattern of transfer to the customer.

136. Furthermore, some respondents, especially preparers from the software industry, requested the Boards to provide further guidance on applying the residual approach where more than one performance obligation in a contract comprises goods or services that have prices that are highly variable or uncertain. One respondent suggested that, in such cases, an entity should be permitted to use the other estimation techniques in paragraph 73 of the exposure draft to allocate the

residual amount of transaction price between the distinct goods or services that have highly variable or uncertain prices.

137. In addition, some other respondents from the financial services industry requested guidance on how the proposals should apply to financial service fees that are not accounted for as part of the effective interest rate of a financial instrument. For instance, they noted that the amount of the deposits that a customer has with a bank may influence whether, and how much, the bank charges the customer for the related banking services provided. Those respondents queried whether, and how, an entity would determine and allocate the transaction price between the deposit (which would be within the scope of the financial instruments standards) and the services (which would be within the scope of the revenue standard).

Allocation of discounts

138. Some respondents suggested that the proposals in paragraph 75 of the exposure draft that specify the circumstances where a contractual discount is allocated to only part of a contract are too restrictive and, as such, the proposals may lead to outcomes that do not faithfully reflect the economics of the transaction. One respondent suggested that the allocation of the discount should be determined by considering the quality of the evidence about where the entire discount belongs rather than by requiring (as proposed in the exposure draft) that the entity regularly sells each good or service on a stand-alone basis and that those observable selling prices provide evidence of where the entire discount belongs.

The basis for allocation

139. The proposals would change the method that almost all entities in the telecommunications industry currently use to allocate the transaction price for contracts that bundle together the sale of a mobile phone handset with an agreement to access mobile phone network services (eg the customer can make a specified amount of calls and use a specified amount of data during each month of the contract without a further charge). That basis of accounting is often described as the ‘contingent cap’ because the amount of the transaction price that is allocated to a satisfied performance obligation (ie the transfer of the handset to the

customer at contract inception) is limited to the amount that is not contingent on whether the entity fulfils the remainder of its performance obligations in the contract (ie providing the promised network services to the customer). The practical consequence of this accounting policy is that the entity recognises as handset revenue any amount of consideration received at contract inception. Hence, in the case of a ‘free’ handset bundled with a network services contract, no amount of revenue is recognised when the handset transfers to the customer. One of the reasons why the Boards decided to not include the contingent cap as a method for allocating transaction price is because the resulting accounting outcome would be inconsistent with the core principle of the proposed model.

140. Those respondents raised several concerns with applying a relative stand-alone selling price allocation methodology to their contracts. Those concerns can be summarised as follows:
- (a) The allocation methodology would generally result in a higher portion of the transaction price being recognised as revenue at contract inception (ie for the handset). As a consequence, an entity would recognise a contract asset for the difference between the revenue recognised and the consideration payable at contract inception. Some respondents disagree with recognising this contract asset because the entity would only be entitled to future economic benefits embodied in that asset when and as it provide the network services to the customer. Respondents also noted that recognising a contract asset has implications for accounting for the time value of money and for impairment.
 - (b) The allocation methodology would generally result in the recurring stream of associated network service revenues being proportionately reduced. Thus, revenue would be recognised at an amount that is different from the amount of consideration that the entity is entitled to receive from the customer as the network services are provided. Information about that recurring amount of consideration is used by

management to manage the business and is used by financial statement users to assess the entity's performance and prospects.

- (c) Most handsets are not regularly sold separately in the retail market and therefore any observable sales of those handsets in that market are not considered to be indicative of the price of those handsets in a bundled offering. Instead, respondents suggested that an entity would be required to estimate the stand-alone selling price, however they noted that this would increase the subjectivity and reduce the comparability of the entity's revenue information.
- (d) The proposal to estimate stand-alone selling prices and allocate the transaction price would substantially increase an entity's compliance costs because existing accounting systems do not capture the information necessary to perform those calculations. Furthermore, preparation challenges associated with performing a relative stand-alone selling price allocations are compounded by the volume of contracts and the various permutations within contracts (eg given the wide variety of handsets and network services plans available). As one respondent explained:

The allocation of a portion of service revenue to reduce the amount of handset subsidy will also require significant revisions to our billing systems which track monthly transactions for approximately 100 million customers. Furthermore, it introduces estimates and assumptions into our accounting process that will ultimately result in reported financial information that is more costly, but less useful, to the users of the information. The amount of estimation and judgement required by the model will not only increase the risk of errors and misstatements, but will also result in unnecessary efforts by the auditors, as they attempt to validate such assumptions. (CL #119)

141. The respondents were also concerned that, unlike current practice, the proposals would result in the pattern of revenue recognition being different for sales from the direct channel (ie own store sales of subsidised handset bundled with a network services contract) and sales from the indirect channel (ie dealer sales of a network service contract on an agency basis in exchange for a commission from the entity). The different revenue recognition patterns would arise because, in the direct channel, some of the transaction price would be allocated to the subsidised handset whereas, in the indirect channel, the entity is providing only network services to the customer and, therefore, all of the transaction price is allocated to those services. However, many of the respondents indicated that the revenue recognition pattern should be the same because they are indifferent about whether they acquire a new customer through the direct channel (typically by offering the customer a subsidised handset) or by the indirect channel (by paying a dealer a commission for acquiring the customer).
142. The comparability between the direct and indirect channel would also be affected by the Boards' proposals on contract acquisition costs. This is discussed further in the next section that begins at paragraph 144 below.
143. During outreach activities, some users who analyse entities in the software industry also raised concerns with the basis for allocating the transaction price. Those users indicated that they preferred the existing requirements for allocating the transaction price in software arrangements whereby revenue would be deferred for any delivered items if there is no vendor-specific objective evidence of the selling prices of the undelivered items. Those users were concerned that the subjectivity associated with recognising revenue on the basis of allocations that use estimated stand-alone selling prices would diminish the reliability and comparability of revenue information reported by software entities.

Contract acquisition costs

144. The exposure draft proposes that an entity recognises an asset for the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs. However, an entity can choose to recognise those contract acquisition costs

as an expense if the amortisation period for those costs would have been one year or less.

145. Respondents from the telecommunications industry expressed concerns about these proposals because it would further diminish the comparability between the direct channel and indirect channel (as explained in paragraph X above). That is because, in the direct channel, the cost of the subsidy on the handset that is transferred to the customer (ie the subsidy is any loss on the sale of the handset) would be recognised immediately in the income statement whereas, in the indirect channel, the dealer commission would be required to be recognised as an asset and amortised over the life of the contract. Preparers in the telecommunications industry have suggested that the revenue standard should permit an entity to either recognise the subsidy as a customer relationship intangible asset or recognise the dealer commission as an expense when incurred.
146. Different entities from the software industry have differing views on the accounting for contract acquisition costs. Some entities support the proposals in the exposure draft, especially for long-term contracts whereby an entity pays substantial sales commissions. As one respondent noted ‘As a group, we believe that capitalization is the preferable method of accounting as the commission charges are so closely related to the revenue from the non-cancelable customer contracts that they should be charged to expense over the same periods as the subscription services revenue is recognized’ (CL #8). In contrast, other software entities disagree with the proposal to require those costs to be capitalised, mainly because of the practical challenges involved. Particularly for long-term or bundled service arrangements, some respondents noted that they generally cannot readily distinguish between costs associated with acquiring a contract and costs associated with fulfilling existing contracts. Those respondents suggest that the Boards should permit an entity to make an accounting policy election about whether to capitalise or expense acquisition costs, depending on which approach would best reflect their business model.

We do not agree with the requirement in the revised ED to capitalize and recognize as an asset the incremental costs

of obtaining a contract, such as sales commissions. In the case of sales commissions, it can be difficult to determine when a commission payment is incremental to obtaining a new customer contract, expanding sales into an existing customer account, fulfilling the deliverables in the contract or managing the client relationship... New systems and process changes will be needed in order to implement this requirement for very little benefit to the users of the financial statements... (CL #26)

Licences

147. The exposure draft includes application guidance for licensing and rights to use intellectual property transferred by the entity. That application guidance specifies that an entity should account for the transfer of the licence as a performance obligation that is satisfied at the point in time when the customer obtains control of the rights (paragraph B34/IG34). However the exposure draft explains that if the licence is not distinct from, say, another service promised in the contract, the entity should account for the combined licence and service as a single performance obligation satisfied over time (paragraph B36/IG36).
148. The application guidance for licences represents a change from the 2010 exposure draft that proposed requiring entities to account for licences differently, depending on whether the licences were exclusive or non-exclusive. Many agree with that change. However, respondents to the 2011 exposure draft have mixed views on the proposals in the exposure draft to recognise revenue for a licence at a point in time—unless it is bundled with an additional service or the constraint in paragraph 85 applies, in which case revenue is recognised over time as sales occur. Those views generally result from in their view, differences in the economic substance of different types of licences.
149. Respondents highlight that these differences in economic substance of the transactions is not reflected by the proposed accounting because the application guidance is too rules-based and it doesn't reconcile easily with other critical parts

of the model such as the principles on identifying separate performance obligations and the criteria for determining when a performance obligation is satisfied over time.

150. Many respondents explain that the entity's performance often differs depending on the nature of the licence. In particular, respondents highlight that often their performance is not complete upon the transfer of a licence (ie at the point in time) as indicated in BC316. Furthermore, many explain that the entity's performance is not necessarily as a result of a service that is in addition to the transfer of the licence (as contemplated by paragraph B36/IG36) but rather is integral to the transfer of the licence, because without the entity's on-going performance, the initial licence is worthless (eg the granting of broadcasting rights to sports games for which, without the continuous scheduling of games, the initial right is worthless, or the transfer of a brand that must be maintained). In their view, the critical nature of the on-going performance of the entity in these transactions is reflected by the payment terms, which are usually over time, rather than upon the initial transfer of the licence.
151. Respondents also highlight that the intangible nature of the licence and the entity's on-going performance make it difficult to apply the criteria for identifying separate performance obligations. In addition, the intangible nature of the licence also makes it difficult to apply the criteria for determining whether performance obligations are satisfied over time, in particular the notion of alternative use.
152. When considering the issue related to licences, respondents requested the Boards to reconsider the scope of the leases and revenue project as they relate to licences and other intangible assets.

Other specific comments

153. As noted above in paragraph 17, some respondents commented that additional implementation guidance and/or examples would be helpful. These respondents requested that the Boards clarify the effect on their particular fact patterns of some of the proposals including, but not limited to, the following:

- (a) Noncash consideration;
 - (b) Bill-and-hold arrangements;
 - (c) Customer renewal and cancellation options;
 - (d) Warranties;
 - (e) Customer acceptance; and
 - (f) Breakage.
154. In addition, some of the comments on those proposals indicate that the drafting of the proposals may be unclear. Others indicate that some of those proposals might yield results that are inconsistent with respondents' perceptions of the economics of their transactions.

Consequential Amendments

Transfers of non-financial assets (Question 6)

155. Question 6 in the exposure draft asked respondents for feedback on the Boards' proposal to amend other standards that would require entities to apply the control and measurement guidance in the exposure draft to transfers of nonfinancial assets that are not an output of an entity's ordinary activities. This question was also included in the 2010 exposure draft as Question 17; however, feedback on that question in 2010 was limited.
156. A reasonable number of respondents commented on question 6 and almost all agree with the proposals. Many explained that, in their view, the amendments will achieve consistency amongst different standards and separate asset classes. However some of those in agreement provided no rationale to support their response.
157. In contrast, some respondents agree in principle, but request clarification on how to account for a transaction in which an asset is transferred to another party in exchange for both fixed and variable consideration. For instance, respondents highlight that when a nonfinancial asset is transferred to another party for both

fixed and variable consideration, the amount of variable consideration included in determining the gain or loss upon transfer is constrained to the amount to which is reasonably assured, which may be nil. In such cases, respondents highlight that the constraint may result in a loss being recognised upon derecognition of the transferred asset, which in their view might be inappropriate. Furthermore, these respondents highlight that without adequate guidance on accounting for these transactions, diversity in practice may occur. However, respondents also explain that the guidance does not exist in current US GAAP and note that this issue has been referred to the EITF.

158. Finally, a few respondents suggest that prior to implementation, the proposed amendments to other standards for the transfer of nonfinancial assets should be evaluated more thoroughly in a separate project. Some respondents thought that the issue merited more thorough evaluation than was apparent from the basis for conclusions, because they noted that the proposals would result in gains and losses on disposals of financial assets and some other assets being recognised on a fair value basis whilst gains and losses on disposals of other non-financial assets would be recognised on a 'reasonably assured' basis. They recommended that the Boards give more consideration as to which model is more appropriate for each particular scenario

Other consequential amendments

159. The 2010 exposure draft included only a summary of the proposed consequential amendments to other standards and many respondents had therefore requested the Boards provide the full text of the amendments. Accordingly, both Boards released the full text of their respective consequential amendments for public comment in connection with the publication of the exposure draft in 2011.
160. The IASB included the proposed consequential amendments to IFRSs in the exposure draft as *Appendix D - Amendments to other IFRSs*. The FASB issued its *Proposed Amendments to the FASB Accounting Standards Codification* as a separate document on January 4, 2012. The FASB asked two questions related to the proposed amendments, specifically whether respondents agree with the

consequential amendments and furthermore whether they agree that the exposure draft has been codified correctly.

161. Not many respondents commented on the consequential amendments. Those that did commented on the proposed amendments to the codification (FASB) separately from the proposed amendments to IFRSs. However, a few responses suggested that prior to issuing a final standard both Boards do a more thorough analysis of the consequential amendments to better understand their effects.

Proposed amendments to the codification (FASB)

162. The few respondents that commented on this section focus their remarks on the amendments that would directly affect their respective industries. Generally, these comments ask that the Boards retain parts of some superseded sections of the codification that illustrate industry-specific terminology and background information that they think may be helpful to preparers and users. For example:
- (a) Commentators from the health care industry disagree with the deletion of the definition of a “prepaid health care plan” from the Master Glossary. They note that without a clear indication that prepaid health care plans are considered healthcare entities (within the scope of Topic 954) health care entities may misapply the guidance in Topic 944, Insurance Entities, to these arrangements, instead of applying the relevant guidance in Topic 605, Revenue Recognition.
 - (b) Commentators from the financial services industry raise concerns that the practice of netting underwriting revenues against underwriting costs will be superseded (currently provided in Topic 940-605-05-1). These respondents note that the current guidance is consistently applied and well understood. However, as a result of the consequential amendments, the industry will report underwriting income gross rather than net, a practice that may provide less meaningful information to users who are more interested in overall profitability of these transactions.

Proposed amendments to IFRSs (IASB)

163. Along with those who responded to the FASB-specific amendments, IASB respondents echo similar concerns about the proposed removal of some parts of existing interpretations and other revenue guidance. For instance, a few respondents question why the IASB chose to withdraw rather than amend IFRIC 18 *Transfers of Assets from Customers*. These respondents note that application issues may arise in respect of fact patterns discussed in IFRIC 18, especially if the revenue and leases standards have different effective dates. Other respondents indicated that they thought the guidance in the exposure draft on exchanges of non-monetary items was inadequate to replace SIC-31 *Revenue—Barter Transactions Involving Advertising Services*.
164. In addition, some respondents raised questions about some specific amendments and request the IASB further clarify the interaction of the proposals with some existing standards. For example, some questioned the interaction of the proposed amendment to exclude contracts with customers from the onerous test in IAS 37 and the requirement to recognise provisions under the impairment of inventory test in IAS 2.
165. Some respondents suggest that the instead of addressing some issues as consequential amendments, the IASB should embark on separate projects to improve existing IFRSs. For instance, respondents suggest that the accounting and disclosure requirements relating to costs to fulfil a contract should be addressed as an amendment to a separate IAS 2 overhaul project, rather than being included in the revenue standard. Similar comments raise the same concerns in relation to the proposed amendments to the disclosure requirements in IAS 34.