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Sir David Tweedie  
Chairman of the  
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Your reference

Our reference

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Date June 19, 2009

Subject Discussion Paper 'Preliminary Views on Revenue Recognition in Contracts with Customers'

Dear Sir David,

We are pleased to have the opportunity to comment on the above mentioned Discussion Paper issued by the International Accounting Standards Board (IASB). In this letter we would like to set out our general comments on the Discussion Paper. The appendix of this letter provides you with our detailed comments on specific issues raised in the Discussion Paper.

We welcome the initiatives taken by the IASB and the FASB in order to implement one single revenue recognition model and to eliminate the inconsistencies between IAS 11 'Construction Contracts' and IAS 18 'Revenue'. However, we do have some major reservations concerning the proposals. In summary, our key issues are as follows:

- In general, we doubt that it is really necessary to create a complete new approach of revenue recognition or whether it is sufficient to eliminate the weaknesses of the existing standards IAS 18 and IAS 11. For many kinds of contracts the proposed approach would be applicable but there are also some special kinds of contracts for which the proposal in the discussion

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paper is not adequate. We explain these difficulties on the example of a long-term contract in the logistics industry.

- Additionally, we have concerns that the discussed approach would lead to more decision-useful information provided in the financial statement. Revenue would be recognised much later than at present practice. The new approach will lead to a significant change to existing accounting. From our point of view it would be necessary to clarify the treatment of contracts which are satisfied or performed continuously over the life of the contract.

We would be pleased to discuss our comments with you at your convenience. If you have any questions, please feel free to contact:

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Yours sincerely,

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Enclosures

## Appendix

### *Chapter 2: A contract-based revenue recognition principle*

#### Question 1

**Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?**

Answer:

In general, we understand the boards' proposal of a revenue recognition model which focuses on a single asset or liability resulting out of an entity's contract with a customer.

However, from our point of view it is questionable whether the complete approach of revenue recognition has to be adjusted or whether it is sufficient to clarify the weaknesses of the existing standards IAS 18 and IAS 11. For us the major weaknesses are the missing guidance relating to the distinction between acting as principle or as agent and the missing accounting treatment/guidance for multiple-element arrangements.

Nevertheless, we believe that the approach based on contracts with customer is an adequate way. Entities providing goods or services to customers enter into contracts with customers. This activity belongs to the 'core-business' of each entity. Therefore, from our point of view it is quite correct to consider the contract as a whole and consequently it makes sense to recognise a contract asset or a contract liability.

#### Question 2

**Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?**

Answer:

The main question is whether the Boards would like to develop one single approach for all kinds of revenue or whether the Boards prefer several approaches for several kinds of revenue.

In general, we prefer one single approach for all kinds of revenue. We do not see any reasons why the proposed approach would not fit for specific types of contracts. We follow the arguments of the boards that the contract with the customer is the basis on which revenue should be recognised. This is equal for all kinds of industries.

However, in case of a long-term contract revenue probably would only be recognised at the end of the contract (which means: at that time when the complete performance obligation is

satisfied). We are a logistic company and therefore we would like to explain the difficulty on the example of a logistic contract. A typical contract in our industry looks as follows: We enter into a 10-years supply chain contract where we agree to do the whole logistics for our customer. This includes e.g. the purchase of goods from a supplier and the whole logistics like warehousing and the distribution to the customers' customers. The questions in case of such a contract are:

- What exactly is the performance obligation?
- What is the unit of account: How many performance obligations do we have?
- Do we have separate enforceable obligations?
- When is the performance obligation satisfied: Is it satisfied at the end of the contract (which would mean that we could recognise revenue only at the end of the contract) or does the delivery of the promised asset (=logistic service) happen at different times so that we could recognise revenue during the contract life?

Following our example, we have a twofold contract, which means that we have a contractual relationship with our customer and additionally we have a contractual relationship with the supplier. Both contracts are linked: We would not have the contract with the supplier if we had not the contract with our customer. If we follow the definition of a contract in the discussion paper we have 2 separate contracts. However, the contract between us and the supplier would never lead to revenue because we do not have a contract with a 'customer' as defined in the discussion paper but with a supplier.

Thus, we only have to analyse the contract between us and the customer. On the one hand, we have to determine the rights and obligations out of this contract. We have the right to the customer's payment. Normally, the customer has to pay for our services monthly. On the other hand, we have the obligation to deliver our service (the logistics) for a period of 10-years. Normally, we deliver our service continuously which means that it is day-by-day-servicing. Our right to the customer's payment depends on the service we rendered the previous month. Assuming that payment and delivery are simultaneously we have a balance between the remaining rights and the remaining obligation at the end of each month. Therefore we would not recognise a contract asset or a contract liability in the balance sheet, but revenue would be recognised for each month.

The change in performance obligation is a trigger for revenue recognition. This change in performance has to be originated by the entity and not by the customer. This means that we could recognise revenue when we rendered our service. Assuming that payment and delivery are at different times (i.e. delivery within the month and payment some days after month end), our obligation to perform would be reduced at the end of the month and the right to payment is still alive. So we have to recognise a contract asset which is a receivable. This contract asset would be released in case of payment by the customer.

However, this only would work in case we interpret the 10-year-contract (= 10-year performance obligation) as dividable into monthly parts. In the case that we consider the contract as an undividable 10-year-contract, e.g. because the monthly parts do not satisfy the criterion of being separate enforceable obligations, which is satisfied at the end of the contract life, it would only be allowed to recognise revenue at the end of that time. From our point of view this cannot be the proposal of such an approach as it would not represent the economic substance of such contracts.

So, we would like to ask the Board to clarify the definition with respect to contracts which are satisfied or performed continuously over the life of the contract, e.g. in case of a long-term contract in which service is rendered.

### Question 3

**Do you agree with the boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.**

Answer:

The discussion paper proposes the following definition of a contract: A contract is an agreement between two or more parties that creates enforceable obligations. This agreement does not need to be in writing to be considered as a contract.

In our view, this definition is a very strict definition because the existence of a contract depends on the enforceability criterion. For us it is unclear if the enforceability must be a legal enforceability. With respect to the analogy to U.S. legal definitions of a 'contract' (par. 2.13), it seems to be legal enforceability. However, in par. 3.6 of the discussion paper it is made reference to terminology of current IAS 37 by using the expression 'constructive obligation', which is, in terminology of IAS 37 defined as not being a legal obligation. We recommend a clearer wording on what is meant by 'enforceability'.

From our point of view an economic interpretation is the more relevant perspective. This would mean that the definition in IAS 32.13 would be more adequate.

This is also laid down by the boards. However, we do not understand why the boards propose a wording different from the definition in IAS 32.13 but stating at the same time that both wordings are consistent. We recommend using the same wording if the respective definitions really are intended to be equal.

### Question 4

**Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.**

Answer:

We doubt that the definition of a performance obligation helps entities to identify consistently the deliverables of a contract. The 'performance obligation' is a high-level notion which perhaps helps to understand the boards' way of thinking. In our opinion, it is not suitable to be applied in practice.

### ***Chapter 3: Performance obligations***

#### **Question 5**

**Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?**

Answer:

The discussion paper proposes that an entity needs to separate a contract's promise into separate performance obligations only when the customer receives the promised assets at different times.

At first sight, this seems to be a quite clear criterion. However, we think that the timing differences in satisfying a performance obligation is not an adequate criterion for breaking up the total performance obligation. We think it is more a question of how closely related the several performance obligations are. If several performance obligations are identified, it has to be checked how these performance obligations depend on each other and how closely related they are. Depending on this a performance obligation has to be separated or not.

In case of the logistics contract described in question 2 it is the question when the customer consumes the service. Does he consume the service on each day/month or only at the end of the contract? From our point of view we think that the customer consumes the services at each day or month. So we satisfy every day or month a part of the whole performance obligation (see question 2).

#### **Question 6 and 7**

**Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?**

**Do you think that sales incentives (e.g. discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?**

Answers for questions 6 and 7:

In our opinion, questions 6 and 7 illustrate that the concept of performance obligations in its current status, although being understandable as a kind of general notion, has conceptual flaws and needs further elaboration in order to be applicable in detailed practice. From our point of view it does not make sense to accidentally discuss these two aspects of contracts; as already outlined before, there probably would be numerous other aspects of (linked) groups of performance obligations or parts of (broken up) performance obligations in contracts to discuss.

## *Chapter 4: Satisfaction of performance obligations*

### Question 8

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

Answer:

As already discussed in question 2 in case of rendering services especially in a supply chain contract it is quite difficult to determine the point in time when the customer received the promised service. Maybe it would be helpful if such a contract was divided into several performance obligations (comparable to procedures followed in application of percentage of completion method). Based on this, it would be definable which service is received by the customer.

However, we agree with the approach that an entity should derecognise an asset when it no longer has control. This approach would be adequate as long as there is no change in the definition of an asset.

### Question 9

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

Answer:

From our point of view revenue would be recognised much later than at present for special long-term contracts. So this will lead to a significant change to existing practice. We are not convinced that this new approach will lead to more decision-useful information than present practice. Please refer to our discussion in question 2. There you can find the difficulties relating to revenue recognition in case of a long-term contract in the logistics industry.

## ***Chapter 5: Measurement of performance obligations***

### **Question 10**

**In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.**

- a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?**

Answer:

We agree with the approach that the performance obligation should be measured initially at the transaction price. We support the arguments against the current exit price approach. From our point of view it is very difficult or quite impossible to measure a performance obligation with an amount that the entity would be required to pay to transfer those obligation. We agree with the opinion of the Boards that a current exit price would rarely be observable for the remaining performance obligations. Further on, the measurement would be very complex and contains several uncertainties which are based on unreliable estimates and therefore offer a high potential for error-proneness.

However, this principle of measuring performance obligations at contract inception at transaction price needs a transaction price to be defined. In the logistics industry, we sometimes have contracts that do not specify definite prices as we are paid by our customers depending on the services actually rendered on a cost-plus basis. This means that a contract with a customer may only have a kind of base volume but no defined transaction price (like a kind of framework contract). In our understanding, we could use the base volume agreed upon as a kind of best estimate for a transaction price. However, the transaction price (or parts of it in case of long-term contracts) will be known later, thus the performance obligation might have to be updated also in other circumstances and not only if it is deemed onerous. Thus, for this kind of contracts we do not agree with the boards' assumption in par. 5.56 that those changes to the contract are not significant.

- b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?**

Answer:

We think this approach would be the most adequate one because it is a clear trigger for an onerous contract if the expected costs are higher than the carrying amount of the performance obligation. The expected costs could be reliably measured.

Using the current price trigger approach entails again a high potential for error-proneness because of several uncertainties regarding the determination of the measurement of the performance obligation in accordance with IAS 37.

Therefore, we support the approach that the cost trigger approach for the onerous test is the most adequate.

However, the discussion paper requires a remeasurement of the performance obligation if the cost trigger is satisfied. This would mean that we get a higher performance obligation. Further on, the discussion paper requires that the satisfaction of the performance obligation leads to revenue recognition. From our point of view this would mean that the release of the 'remeasured' performance obligation shows an overstated revenue. Instead of a remeasurement of the performance obligation we would like to suggest the creation of a provision avoiding an overstated revenue recognition.

### Question 11

**The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (e.g. selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.**

- a) **Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?**
- b) **In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.**

#### Answer:

In general, we agree with this approach. However, we think under dedicated circumstances it might be adequate to capitalise these costs.

We would like to explain this on the example of a logistic contract. In some cases it could be that we as a logistic company have high pre-contract start-up costs which are incurred from the time of winning or securing the contract up to the commencement of operations and services provided. These costs actually occur because we have already rendered a service. Depending on the contract, these expenses could be costs for labour, hiring or transferring staff, travel cost, cost for moving goods to warehouses, hard- and software IT-costs, any professional fees in preparing contracts, training, etc. As long as the criteria for capitalizing an asset are not met these costs have to be expensed in the income statement.

However, if parts of these costs qualify for capitalization of an asset, then (again) we face the problem of defining the performance obligation towards our customer and the corresponding satisfaction of performance obligation. Consider the following example:

For a new and specified logistics contract, we have to invest in a new IT-environment for a specified warehouse. Assume that the IT is under our control and, thus, has to be capitalized. We

agreed with the customer to get the costs of the IT (the investment) reimbursed as a cash payment amounting to the whole IT investment at the beginning of the rendering of services. What is our contract position in that case with respect to the IT?

- On the one hand, the performance obligation might be the ‘investment in IT as prerequisite for rendering services’. In our understanding, this would lead to the situation that we show revenue amounting to the whole IT investment, as this part of the total performance obligation has been satisfied and has been paid by the customer. However, costs for the IT are shown in the income statement over several years via depreciation, which does not match with the revenue shown at contract beginning.
- On the other hand, the performance obligation might be ‘using the IT newly invested in by rendering services over total contract period’. In our understanding, this would lead to the situation that the customer already paid, but we did not render our services (did not perform) yet.

In our opinion, this example again and as already outlined above shows that the concept of performance obligations definitely needs to be elaborated in a more detailed way.

### Question 12

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

Answer:

We do not agree with this approach. Especially in the logistic industry it would be quite difficult or impossible to find out a stand-alone price in a way proposed in the discussion paper (5.49 ff).

### Question 13

**Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?**

Answer:

If an entity does not sell a good or service separately, from our point of view it would not be adequate to estimate a stand-alone selling price of the good or service. The estimation of this price would contain a lot of uncertainties which do not lead to a decision-useful basis.