



Madrid, 22 October 2010
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: Exposure Draft ED/2010/6 – “Revenue from contracts with customers”

Dear Sirs,

Repsol is very pleased to provide comments to the International Accounting Standards Board on its request for views on the Exposure Draft ED/2010/6 – “Revenue from contracts with customers”.

You can find below our responses to some of the questions of the Exposure Draft and also some additional comments.

Further information about the Repsol Group and its activities is available on our website: www.repsol.com.

If you would like to discuss any of the points we describe in this letter, please do not hesitate to contact us by e-mail to normativacontable@repsol.com.

Thank you for your attention.

Yours sincerely,

Emilio Linares-Rivas Balius

Accounting Policies and Compliance Manager

Question 5 – Customer’s credit risk

Do you agree that customer’s credit risk should affect how much revenue an entity recognise when it satisfies a performance obligation rather than whether the entity recognises revenue?

We do not agree that customer’s credit risk should affect revenue for the following reasons:

- Revenue amount is widely considered to be an indicator which reflects the quantity of goods or services sold multiplied by prices of these goods or services, that is, it is considered to be a representation of the performance of the entity arising from its ordinary activities. Additionally, in some jurisdictions revenue amount has audit, tax or other legal implications. We do not feel customer’s credit risk (despite indirectly) should have those kind of implications.
- Credit losses are considered to be impairments of financial assets rather than a reduction of revenue.

According to the proposals in the exposure draft, an entity would recognise revenue when it fulfils a performance obligation with a customer.

However, if an entity does not fulfil a performance obligation, for example, because it has sold some goods with latent defects (failed sale), it would appropriately reduce revenue.

From our point of view, a credit loss does not imply a failed sale and therefore customer’s credit risk should not affect revenue amount, as long as the entity properly has fulfilled its performance obligation:

- If an entity has properly fulfilled its performance obligation (that is, has transferred the control of the products in accordance with contractual terms) revenue should not be reduced to reflect the effect of customer’s credit risk, because the sale has been adequately completed. Revenue amount should show the gross amount of the sale.
- On the other hand, credit losses (irrespective of whether they are recognised on the basis of an incurred loss model or an expected loss model) represent a devaluation of the right to receive consideration (i.e. contract asset / financial asset) and should be recognised as “other expenses”, not as a deduction of revenue.

Question 9 – Contract costs

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

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

Contract Costs

Although we feel comfortable with cost accounting requirements in IAS 2 and IAS 11, in general terms we agree with the proposals in the Exposure Draft relating to which costs should be capitalised. However we think that in some circumstances costs of obtaining a contract should be capitalised.

Unit of account for onerous liabilities

We do not agree with the fact that an entity should recognise an onerous liability at a performance obligation level. We do not consider that accounting requirement would lead to useful information when the contract, evaluated as a whole, is profitable.

In addition, recognising onerous liabilities at a performance obligation level would be inconsistent with the unit of account that is considered when recognising other onerous liabilities, such as lease or executory contracts (IAS 37). We feel the proposals in the exposure draft do not constitute an improvement over IAS 37 requirements, which are based on a “contract approach”.

We consider that applying the onerous test at a contract level provides useful information: as contracts are unbundled into performance obligations, and revenue is recognised based on the satisfaction of these, a loss would be recognised when an onerous performance obligation is satisfied.

Measurement of contract costs in the onerous test

The Exposure Draft proposes to recognise a liability for an onerous performance obligation if the present value of the probability-weighted costs that relate directly to satisfying a performance obligation of contract costs exceeds the amount of the transaction price allocated to it.

If the IASB proceeds with the approach of recognising an onerous liability at a performance obligation level, and as we commented in our response to exposure draft “Measuring Liabilities in IAS 37” we consider that an “expected value” on a probability-weighted basis, depending on facts and circumstances, could be a useful method for estimating the uncertainty surrounding liabilities. This would be also the case for contract costs. However, we are not convinced that this is the best method for estimating contract

costs in every contract. In fact, we think that sometimes the “most likely outcome approach” provides useful information for users of financial statements.

Question 14 – Application Guidance

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

We note that the Board has made efforts in order to develop a complete guidance which assist preparers in applying revenue recognition and measurement requirements. We are not sure if illustrative examples included are sufficient to cover the needs of every industry. However, we would like to focus on a specific issue, which is not clearly addressed in the application guidance, but could have an impact on financial statements.

Paragraph B91 covers presentation requirements, and several illustrative examples are included. Example 2, refers to a non-cancellable contract, signed on 1 January and which requires to the customer to pay on 31 January. The customer pays on 15 February and the entity transfers the product on 31 March.

On 31 January, and even though neither the customer nor the entity have fulfilled their obligations, it is considered that the entity has obtained an unconditional right to consideration and, therefore, recognises a financial asset (representing that right) and a contractual obligation (representing its commitment to transfer the product to the customer).

Subsequently, at the end of the example, it is stated the following:

“If the contract were cancellable, the entity would not make the above entry on 31 January (i.e. recognition of financial asset and contract liability), because it would not have an unconditional right to consideration. Instead, it would recognise the cash and contract liability on 15 February”.

Unfortunately, the concept “non-cancellable” is not defined in the exposure draft. The only reference is included in BC166:

“For example, an entity may enter into a non-cancellable contract that requires the customer to pay the consideration a month before the entity provides the goods or services. On the date when the payment is due, the entity has an unconditional right to consideration”.

We consider the IASB should clarify what “a non-cancellable contract” means, or in other words, which conditions would lead to a contract being considered as non-cancellable. In this sense, we wonder if those conditions would be similar to the ones included in current IAS 17 in relation to “non-cancellable leases”.

Summarising, we consider the IASB should provide a clear definition of “non-cancellable contract”, considering that other terms such as “wholly unperformed contract” (paragraph 11) are properly defined in the exposure draft:

“A contract does not exist for the purpose of applying this [draft] IFRS if either party can terminate a wholly unperformed contract without penalty. A wholly unperformed contract is a contract under which the entity has not transferred any goods or services and the customer has not paid any consideration”.

Question 17 – Consequential Amendments

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

Conceptually we agree that requirements for recognition and measurement of gains or losses on the sale of some non-financial assets should be consistent with the requirements of revenue recognition standard. However, and consistently with our response to question 5, we consider gain or loss on disposal of a non-financial asset (for example an element of property, plant and equipment) should not be affected by the purchaser’s credit risk.

Additional comments

Even though we consider that a revenue recognition standard should only address accounting requirements from the point of view of the entity that sells products or provides services, we feel there is a lack of guidance about accounting treatment by customers.

We note that IAS 2 has not been proposed for amendment, except for the scope exclusion of “construction contracts” and the deletion of the guidance for contracts costs for a service provided. However it seems that this exposure draft could have implications in the accounting requirements for customers that are intermediaries who assume control and risks and rewards inherent to the goods acquired (i.e. the ones that register acquisition of inventories).

For example, it is logical that a customer under the proposals of the exposure draft would recognise purchases of inventories when gaining the control of the products. However, it is not clear if other recognition or measurement requirements would also be applicable to customers by analogy, in absence of specific guidance in other Standards:

- For example, if an entity receives a long-term payment in advance, it should recognise a contractual liability which would be increased by the recognition of a financial expense. When the entity satisfies its contractual obligation, it shall derecognise contractual liability against revenue. As a consequence of the accounting

requirements the entity would have recognise higher revenue due to the recognition of the financial expense.

How should the customer account for a long-term payment made in advance?. It is supposed that customer should apply an accounting requirement equivalent to the one applied by its supplier, that is to recognise financial income which would increase progressively the carrying amount of the asset and recognise subsequently (in the event of purchasing inventory) a higher operating expense?. We feel that under current IFRS there is a lack of specific guidance in relation to these long-term prepayments, and therefore a clarification by the IASB would be welcomed.

- Another example would be the accounting treatment for contingent consideration. If a customer purchases inventories but pays in arrears and transaction price is contingent because a discount per volume could be obtained in subsequent months, should the customer apply contingent consideration guidance in paragraphs 36-41 and B77 for sellers of goods / service providers?. That is, should the customer estimate the expected value of the transaction price considering the potential discount? Or on the contrary should apply cost of purchase guidance in IAS 2?.