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

Comments on the Exposure Draft *Revenue from Contracts with Customers*

To the Board Members:

The Japanese Institute of Certified Public Accountants (“we” and “our”) appreciates the continued efforts of the International Accounting Standard Board (IASB) on the project to improve financial reporting of revenue, and welcomes the opportunity to comment on the revised exposure draft (ED), *Revenue from Contracts with Customers*.

The revised ED incorporates most of the feedback received from the 2010 exposure draft. We believe that the revised ED has significantly refined the original proposals, by further clarifying the revenue recognition principles and properly reflecting how an entity could apply the new proposals in practice. We also would like to express our sincere appreciation to the IASB for the extensive outreach activities and public round-table discussions related to the revised ED.

With that having been said, however, there are some areas that still need to be improved in the revised ED. For example, with respect to the criteria on “performance obligations satisfied over time” stated in paragraph 35, we would like to strongly request to revise it so that the underlying revenue recognition principles would become more evident. In addition, we would also like to suggest to include illustrative examples that can be

referred to in practice, as there is some possibility of changing significantly the ways entities currently recognize revenue. Likewise, since the revenue recognition standard will have considerable impact on the practice of financial reporting by entities, we also hope for the boards' initiative in alleviating some of our concerns stated in this comment letter when analyzing feedback from respondents.

The following is our response to the items in 'Questions for respondents' with which we disagree or have questions or concerns. Our comments stated under the heading of "Other Related Comments" in the last part of this letter relate to the issues that we have come across when reviewing the revised ED.

Question 1

Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

Comments:

We agree with having provisions related to performance obligations satisfied over time stated in paragraphs 35 and 36, since these will help to appropriately depict the transfer of promised goods or services to a customer. We also agree with the IASB's view that, by inserting paragraphs BC90 and BC91, it intends to maintain the concept that is similar to the existing percentage of completion method in revenue recognition.

However, since there may be different practices depending on how an entity interprets the requirements in paragraphs 35 and 36, particularly for those issues stated below, it is necessary to revise the requirements and improve the illustrative examples, in order to further clarify IASB's intention stated above.

- (1) The proposed paragraph 35 (a) sets a general requirement on the transfer of control that: "(A)n entity shall apply the requirements on control in paragraphs 31–33 and paragraph 37 to determine whether the customer controls an asset as it is created or enhanced." We believe that further clarification of this statement will be necessary to apply the requirements on control stated in paragraph 37, related to the performance obligations satisfied over time. For example, even typical goods transferred over time, such as construction or production within the customer's premises are rarely subjected to the indicators stated in paragraph 37 (a)–(e) in determining whether the customer controls the created or enhanced portion of an asset before the completion of entire delivery. This refers to the present right to payment, the transfer of legal title as well as physical possession or risks and rewards, and the customer's acceptance of the asset.
- (2) With regards to the requirement that "the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as it is created or enhanced", as stated in paragraph 35 (a), it would be difficult to apply this requirement to those goods that are not constructed or produced within the

premises of customers, but rather constructed within the entity's premises, such as manufacturing of large equipment, construction of ships, and entrusted development of computer software. Accordingly, in many cases, these may fall into the performance obligations satisfied at a point in time. However, it is our understanding that under the current practices, the percentage of completion method has been primarily required in most of those cases. Therefore, we request the Board to revise this requirement to clarify whether the percentage of completion method is still permitted under the new provisions, and add related illustrative examples.

- (3) When build-to-order manufacturing of large equipment, construction of ships, or entrusted development of computer software do not meet the requirement under paragraph 35 (a), the next consideration will be assessing whether they will meet the requirements under paragraph 35 (b) (iii), when considering whether to permit the percentage of completion method. In Japan, there are not many cases when an entity's right to payment for completed performance is specifically stated in the written agreements. Furthermore, there are some contracts that include articles on penalties, required in the event of mid-term cancellation request by customers. However, it is not clear from the proposed requirements whether these circumstances may fall under a case for an entity having the right to payment. Moreover, there may be cases when an entity cannot come to an agreement with a customer about its right to payment for performance completed or for compensation that recovers entity's costs plus a reasonable profit margin, even when their contract includes provisions on penalties required for the request of mid-term cancellation. It is also not clear from the proposal whether this may come under a case when an entity is said to have no right to payment. Therefore, we suggest clarifying an entity's right to payment in paragraph 35(b) (iii) and adding appropriate illustrative examples.

Question 2

Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

Comments:

We do not agree with the proposal.

We assume that, in practice, most entities protect their rights by receiving collateral or advance payments before entering into transactions with customers with high credit risks. It is unreasonable to proceed without taking any measures against lowering those risks.

Alternatively, it would be useful to require entities, which have recurring transactions with customers with high credit risks, to present amounts of uncollectable consideration corresponding to the effects of the customer's credit risks, as a separate line item adjacent to the revenue line in the financial statements, since these entities are most likely to have reflected customer's credit risk in their transaction price.

Therefore, as an alternative to the proposal, we recommend requiring an entity to present any impairment losses as a separate item adjacent to the revenue line item, but only for an entity which has recurring business with customers with high credit risks.

Question 3

Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognizes to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognize for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

Comments:

We do not agree with the following aspects.

- (1) We generally agree with the proposal that the amount of revenue the entity recognizes should be limited to the amount to which it is reasonably assured to be entitled. However, we believe it will be appropriate to clarify that, even when the consideration is variable, when some portion of it can be reasonably assured, an entity should recognize this portion in its financial statements.
- (2) Further clarification in the proposal will be required for whether or not the quantitative measurement, such as the measurement of expected values or the most likely values, will be required for the portion of the amount of consideration that the entity's entitlement is reasonably assured. If a quantitative measurement is required when recognizing revenue, it will be necessary to consider whether this requirement is consistent with other requirements relevant to revenue recognition. For example, if the expected value will be used as a cap to the portion that is reasonably assured by an entity, there may be a risk that the revised upward portion, which may vary depending on the measurement techniques used, may be recognized in advance. On the contrary, there may also be a risk that the entity recognizes a portion that is reasonably assured in advance, while deferring the recognition of the uncertain portion of the amount that is revised downward until the later period of the contract. In this regard, we suggest that best estimates

should be required for an entity, without requiring quantitative measurement for determination of the reasonably assured portion of the consideration.

- (3) In addition to the proposed case, when the amount of consideration to which an entity will be entitled is variable, the Board should also clarify that it would constrain the amount of revenue the entity can recognize when the entity cannot reliably measure the costs incurred or to be incurred in respect of the transactions (IAS 18, Revenue, paragraphs 14 (e) and 20 (d)).

Question 4

For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

Comments:

We do not agree with the following aspects.

Relating to the treatment for onerous contracts, the Board should also reflect on the related provisions in IAS 2 *Inventories* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. BC210 of the proposed ED states that the related provisions should also be referred to, but it does not specifically state whether related provisions in other requirements, such as those stated in IAS 37, will also be modified according to the new principles of revenue recognition.

- (1) We believe the scope of the onerous test does not need to be limited to “a performance obligation that an entity satisfies over time and that the entity expects at contract inception to satisfy over a period of time greater than one year.” We understand that the purpose of limiting the scope as such is proposed as a practical expedient by taking into consideration the existing requirements on materiality. However, the degree of materiality is perceived differently in each entity, and we believe that defining the scope uniformly according to a period of time will not always reflect their ordinary practices.
- (2) For the unit of accounts for applying the onerous test, the Board should require an entity to properly disclose the information about decisions made, and should also

clarify the relationship between IAS 37, particularly with respect to whether or not an entity can apply the onerous test on the individual contract base. Since we assume that profitability is generally managed by entities along the lines of each contract agreement, the Board should not necessarily prohibit an entity to apply the onerous test based on each contract.

Question 5

The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports. The disclosures that would be required (if material) are:

- The disaggregation of revenue (paragraphs 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- An analysis of the entity's remaining performance obligations (paragraphs 119–121)
- Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
- A tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.

Comments:

We do not agree with the proposal.

Among the items to be disclosed listed in the Question 5, the quantitative information noted below is not directly related to the recognition of revenue, and benefits to the users of that information would not exceed the costs incurred in preparation and auditing of those information. Therefore, we believe it is sufficient to request disclosure of qualitative information listed below, and that disclosure of quantitative information should only be encouraged for entities on a voluntary basis.

- A tabular reconciliation of contract assets and contract liabilities
- An analysis of the entity's remaining performance obligations
- Information on contract costs and obligations from onerous performance obligations.

Additionally, we believe that the Board should remove examples (d)–(g) in paragraph 115 from the examples of categories for disaggregation of revenue that might be appropriate, since benefits would not exceed the costs incurred in preparation and auditing of such information.

We are of the same position as stated above, relating to the disclosures for annual financial statements.

Question 6

For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

Comments:

We do not agree with the proposal.

We believe that property, plant and equipment and the intangible assets have characteristics as noted below. We request the IASB to prepare additional guidance in reference to those characteristics when finalizing the proposed requirements or other related standards, as they are not sufficiently considered in the proposed ED.

(Property, plant and equipment)

- Even after the sales of goods, there may be continuing involvement in the form of repurchase agreements or leaseback arrangements.
- In most cases, it is difficult to measure property, plant and equipment at fair value, compared to the measurement of inventories.

- It may be included in special financial arrangement such as SPE, and may fall under the category of the financial transaction.

(Intangible Assets)

- There are some varieties in the performance obligations
- It is sometimes difficult in practice to differentiate whether an entity has licensed the usage to a customer, or whether control has been transferred to a customer.
- It would be much more difficult to identify a part where the control has been transferred to a customer when the intangible assets are used for joint projects.

Other Related Comments

1. Identifying performance obligations

In order to eliminate possibilities of inconsistent applications in practice, we believe for the reasons stated below, that it be necessary to reconsider the proposals relating to identifying performance obligations and develop guidance or illustrative examples.

- (1) Paragraph 28(b) states that “the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer. Readily available resources are goods or services that are sold separately (by the entity or by another entity) or resources that the customer has already obtained (from the entity or from other transactions or events).” This may be interpreted that, even when goods or services are not sold separately by an entity, an entity is required to identify performance obligations, after conducting a close study on the status of the usage by a customer. Therefore, we recommend clarifying that the entity is not expected to gather all of the available information relating to the customer.
- (2) In the paragraph 29(a), it is proposed that “the goods or services in the bundle 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 item(s) for which the customer has contracted.” With respect to this, we are concerned that, since the concepts underlying the words “highly interrelated” or “a significant service of integrating the goods or services” are not clear from this paragraph, the actual application of it in practice may vary. Therefore, we suggest for the Board to improve guidance or provide illustrative examples for this proposal.

- (3) We do not exactly understand what has been specifically assumed in paragraph 29(b), which states that “the bundle of goods or services is significantly modified or customised to fulfill the contract,” and we believe its application in practice will also be difficult. Therefore, the Board needs to consider developing guidance or illustrative examples for this proposal as well.

2. Licensing

- (1) Recognizing revenue from license agreements at a point in time

The scope of the licensing of intellectual properties or other rights to use in the proposed ED is wide, and in practice, the rights to use may vary by time, geography or form of distribution. In addition, license agreements may come in variety of forms. Therefore, as stated in paragraph BC315, there are two ways in which an entity’s performance obligations in license agreements will be satisfied; that is, 1) an entity’s performance obligation is considered to be satisfied at the inception of license agreements when the right to use has been transferred from an entity to a customer, and 2) an entity satisfies performance obligations over time by granting a customer the rights to use continuously during the period of license agreements.

Furthermore, it is usually the case that granting a license or other rights to use requires additional performance obligations and other managerial support from an entity. Therefore, we do not agree with the proposal that, in principle, if an entity grants a license to a customer, a performance obligation is considered to be satisfied at a point in time. Given that there are two ways for satisfying the performance obligations as stated above, we believe that an entity should consider whether a performance obligation is satisfied at a point in time or over time, by taking into account the core requirements stated in paragraphs 31–37. In addition, in order to ensure consistent application in practice, the Board also needs to consider providing guidance on this requirement.

- (2) Treatments for a sales-based royalty

We do not agree with the exceptions of reference to the requirements in paragraphs 81–83, in paragraph 85 regarding treatments for a sales-based royalty. We believe that it will be inconsistent to have an exception like this in the standard, while also having an exception in the revenue recognition for licensing, which is required to be recognized, in principle, at a point in time.

3. The time value of money

With respect to the paragraph 60, it is not clear which period an entity is required to consider, since it may take long time, before the transfer of promised goods or services to a customer will take place for the performance obligations satisfied over time. As such, the Board should clearly define the period by stating, for example, the “closing” period of transfer of promised goods or services to a customer.

4. Ensuring consistency with service concession arrangements

As the IFRIC 12, *Service Concession Arrangements*, is not always consistent with the recognition and measurement principles of the proposed revenue model, the requirements of IFRIC 12 need to be reconsidered.

Yours faithfully,

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Executive Board Member—Accounting Practice (IFRS)

The Japanese Institute of Certified Public Accountants