

29 February 2012

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Dear Board members:

Invitation to comment –Exposure Draft ED/2011/6 A revision of ED/2010/6 Revenue from Contracts with Customers

I am pleased to submit my comments on the above Exposure Draft (ED). Although I support the proposed amendments, I have some suggestion to the boards.

My detailed responses to the questions in the invitation to comment are included in the Appendix A to this letter. Appendix B to this letter includes other observations about the ED that I would like the Boards to consider in its redeliberations.

Yours sincerely,
Yoshinaga Yuko

Appendix A

Question 1: 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?

I agree with the proposal.

Question 2: 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?

I agree with the proposal.

Question 3: Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

I agree with the proposal.

Question 4: Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

I agree with the proposal.

Question 5: 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.

I agree with the proposal. I believe that 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.

Question 6: 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?

I agree with the proposal.

Appendix B - Other observations about the ED

Identifying the contract

- (1) Each party or either party (paragraph 15, BC47)?

While paragraph 15 says “For the purpose of applying this [draft] IFRS, a contract does not exist if **each** party to the contract has...” (emphasis added), BC 47 says “Consistently with that objective, if an entity enters into a contract with a customer that can be renewed or cancelled by **either** party...” (emphasis added).

For consistency, **I suggest the boards amend the wording in BC47.**

Contract modifications

- (2) “Scope” of the contract (18-22)

Paragraph 18 says “A contract modification exists when the parties to a contract approve a change in the **scope** or price of a contract (or both)” (emphasis added). However, it is not clear what “scope” means (For example, is contract renewal a change in the “scope” of a contract?).

For clarification, **I suggest the boards clarify the meaning of the term “scope” used in the contract modification.**

Identifying separate performance obligations

- (3) Performance obligation and obligation which is not a performance obligation (24-25)

I suggest the boards amend the wording of paragraphs 24 and 25.

Paragraphs 24 and 25 explain the nature of performance obligation. I think the Boards’ intention would be better understood by simply stating the difference between performance obligation and obligation which is not a performance obligation. Also, the boards’ intention to introduce control model would be better understood by using the term “transfer a control of promised good or service” instead of “transfer a good or service”. Finally, as ED’s Application guidance prohibits some obligations to be regarded as performance obligation, phrase such as “Unless otherwise stated in this standard” should be added. **My suggested drafting is as follows:**

24 Unless otherwise stated in this standard, A-a performance obligation is an promise-obligation in a contract with a customer to transfer a control of promised good or service to the customer. Performance obligations include promises obligations that are implied by an entity’s customary business practices, published policies or specific statements if those promises-obligations create a valid expectation of the

customer that the entity will transfer a control of good or service.

25 Performance obligations do not include ~~activities~~ obligations that an entity must undertake to fulfil a contract unless the entity transfers a control of promised good or service to the customer as those obligations are fulfilled. ~~activities occur.~~

Breakage

(4) Nature of breakage (B25-B28)

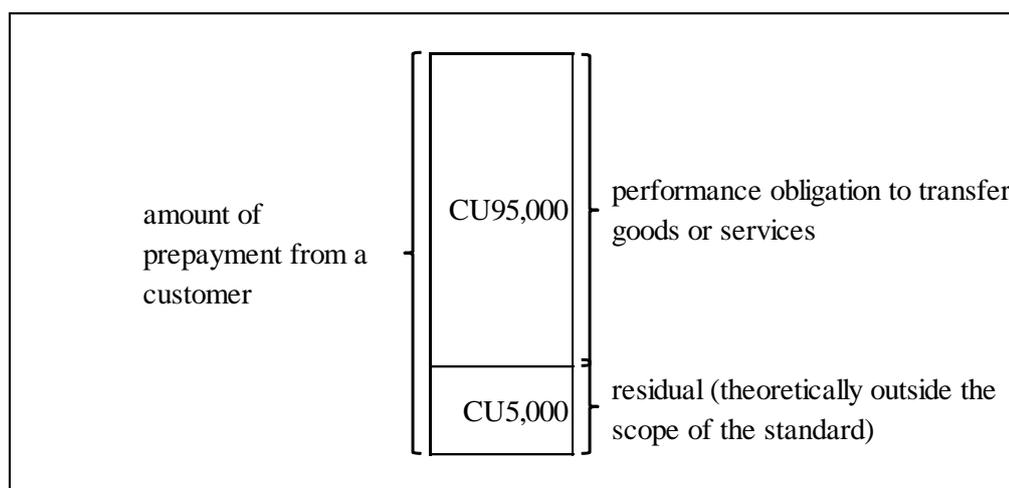
I suggest the boards clarify the nature of breakage to avoid interpretation diversity.

While paragraphs B25- B28 explain about the accounting for breakage, the nature of the breakage is still unclear.

For example, assume that a department store issues gift card of CU 100,000 and the expected breakage amount is CU 5,000. The amount of CU 95,000 would be recognised as revenue when an entity transfers control of promised goods or service to its customer. Breakage revenue of CU 5,000 would be recognised “in proportion to the pattern of rights exercised by the customer”.

ED’s proposal could be interpreted in 2 different ways.

View 1: Breakage is a residual



As B25- B28 seems to require an entity to split prepayment of CU 100,000 into amount that are expected to be exercised (CU 95,000) and amount that are not

expected to be exercised (CU 5,000), in view 1, an entity would account for breakage as an amount of prepayment from a customer less amount of transaction price for goods and services that would be transferred to the customer (i.e., residual).

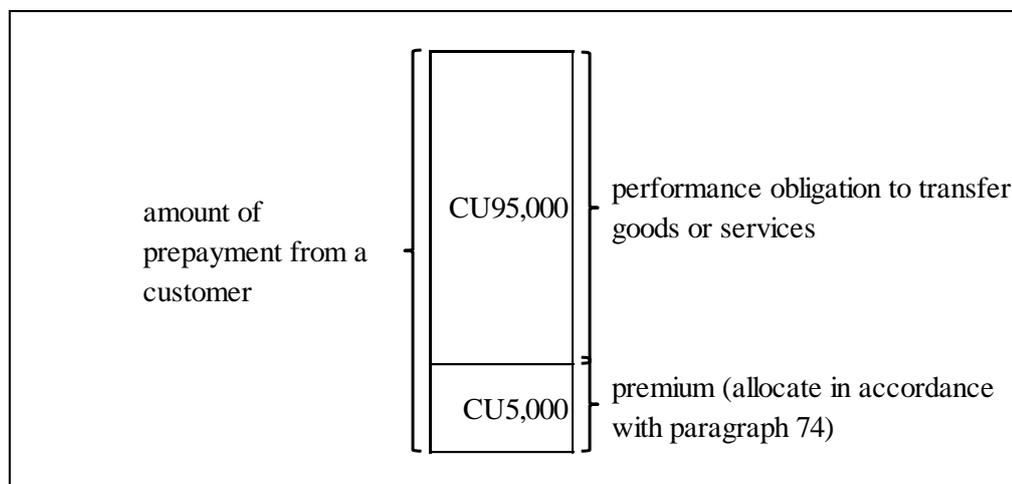
As a breakage is “unexercised rights” (paragraph B26), there are no goods or services to be transferred to the customer (thus, does not meet the criteria set out in paragraph 14). Therefore, theoretically, in view 1, breakage revenue should be out of the scope of the revenue recognition standard.

Accordingly, guidance in B27 which requires breakage revenue to be recognised “in proportion to the pattern of rights exercised by the customer” is an exception to the scope of the standard.

This view would raise additional concerns as follows:

- (a) should breakage be presented as contract liability or liability other than contract liability?
- (b) how should “expected breakage amount” be measured (conversely, how should contract liability be measured if there is a breakage)?

View 2: Breakage is a premium



Breakage could be viewed as premium paid from a customer. While ED provides guidance only for allocating discount (paragraph 74), same concept would apply for the premium. In view 2, breakage would be allocated to performance obligation to transfer goods or services to the customer.

Guidance in B27 which requires breakage revenue to be recognised “in proportion to the pattern of rights exercised by the customer” is an application guidance of principle in paragraph 74. Accordingly, whenever an entity transfers goods or services to the

customer, the amount of revenue recognised would be 1.05¹ times that of the stand-alone selling price.

Customer options for additional goods or services

(5) “Material right” and distinct (26(g), B21)

I suggest the boards amend the wording of paragraphs B21.

As paragraph B21 is an application guidance, “Material right” should be linked to the general guidance of the standard (i.e., “distinct”).

My suggested drafting is as follows:

B21 If in a contract with more than one performance obligation an entity grants a customer the option to acquire additional goods or services, that option shall be accounted for as a separate performance obligation if it is distinct. gives rise to a separate performance obligation in the contract only if ~~†~~The option is distinct only if it provides a material right to the customer that it would not receive without entering into that contract...

(6) Option expiry and breakage (B21, B27)

While paragraph B21 requires an entity to “recognises revenue when those future goods or services are transferred or when the option expires” (emphasis added), it seems to contradict the breakage revenue guidance which requires an entity to recognise “in proportion to the pattern of rights exercised by the customer” (B27).

If there is an expected unexercised option, why should the revenue related to that portion be deferred until its expiry? Or sometimes, option might be open-ended. How should an entity recognise revenue for unexercised option in such case?

I suggest that the boards clarify the requirement in paragraph B20-B24..

Measurement of revenue

(7) Residual approach (73(c))

Residual approach in 73(c) is not the method to estimate the stand-alone selling price. Instead, it is a method to determine the transaction price allocated to performance obligation. Thus, I suggest the boards reconsider the place residual approach would be incorporated in the final standard.

¹ 1.05263...=10,000/9,500

Constraining the cumulative amount of revenue recognised

(8) Application of the requirement to provisionally priced contracts

Sales contracts for certain commodities often provide for provisional pricing at the time of shipment of items with final pricing based on the average market price for a particular future period (the final sales price is often (1) based on the average market prices during a subsequent period or (2) the price on a fixed date after delivery).²

Under IAS 18, an entity recognises revenue arising from such contract at the day it delivers the item to the customer (i.e. at the date when all of the conditions in IAS 18.14 are satisfied) at the market price as of the date. Subsequently, in accordance with IFRS 9, an entity would measure its account receivable at fair value through profit or loss, as it would not meet the condition (b) of paragraph 4.1.2 due to the derivatives embedded in it.

ED 82 (a) states that “volatility in a market” is one of the indicators that an entity’s experience (or other evidence) is not predictive of the amount of consideration to which the entity will be entitled. Does this mean that an entity would not be able to recognise revenue arising from provisionally priced contracts until the date price is fixed?

As this might have a significant impact for companies in specific industries, **I suggest the boards reconsider the wording in paragraph 82 (a).**

Presentation and disclosure

(9) Presentation in the statement of profit or loss and other comprehensive income

I suggest the boards incorporate guidance for the presentation of revenue in the statement of profit or loss and other comprehensive income (SPLOCI).

I believe that providing guidance for presentation of revenue in the SPLOCI would be helpful when applying the new standard in practice. Areas I suggest the boards to consider include the following:

- (a) Should revenue that is in scope of this standard be presented separately from the revenue that is not in scope of this standard?
- (b) Would presenting a non-GAAP revenue in SPLOCI be permitted (especially gross revenue information)³?

² For more detail, see 6.3.1 Provisionally priced contracts, Chapter 41 extractive industries, International GAAP 2012, Ernst & Young, Wiley

³ British American Tobacco presents “Gross turnover” amount as a top line item in the income statement, while Sumitomo Corporation presents “Total trading transactions” as a bottom line item in the Statements of Comprehensive Income. <http://www.bat.com/ar/2010/financial-statements/group-financial-statements/group-inc>

(c) Does an entity have an option to present disaggregated revenue information in SPLOCI?⁴

(10) Meaning of “original expected duration”

While paragraph 119 requires an entity to disclose information “for contracts with an original expected duration of more than one year”, the meaning of the term “original expected duration” is not explained in the standard. This would cause a practical problem for entities which enter into a “month-to-month contract” with their customer (e.g., telecommunications contracts, health club membership contracts). While it is clear that “proposed revenue requirements should not apply to wholly unperformed contracts if each party to the contract has the unilateral enforceable right to terminate the contract without penalty” (paragraph 15, BC 35), usually in practice, customer alone has an “enforceable right to terminate”. In such cases, should an entity apply the definition of “lease term” as defined in IAS17 by analogy to determine the “original expected duration”, or is it initial contractual period stated in the contract with the customer?

To clarify the boards’ intention, I suggest the boards develop the guidance for applying paragraph 119 to “month-to-month contract”. If the boards think that this issue also relates to identifying separate performance obligation for “month-to-month contract”, I suggest the boards clarify the accounting treatment from that perspective too.

[ome-statement.html](#)

http://www.sumitomocorp.co.jp/english/ir/doc/2011f/ar2011_07.pdf

⁴ Currently, Sumitomo Corporation presents “Sales of tangible products” and “Sales of services and others” separately in the Statements of Comprehensive Income. It seems that ED requires such information to be disclosed in the notes, and not in SPLOCI.

Wording suggestion

I suggest the board reconsider the wording in the standard before finalization.

1	paragraph(s): 47
	Suggestion: In some circumstances (for example, in the early stages of a contract), an entity may not be able to reasonably measure the outcome <u>progress</u> of a performance obligation,
	Reason for suggestion: the term "outcome" is unclear. This section is about the Reasonable measures of progress.
2	paragraph(s): appendix A definition of performance obligation
	Suggestion: An promise <u>obligation</u> in a contract with a customer to transfer a <u>control of promised</u> good or service to the customer.
	Reason for suggestion: to clarify that the transfer of “control” (and not just transfer of a physical possession, legal title, or risk and rewards of goods or service) is required to recognise revenue. I also suggest the boards use the phrase “transfer a control of promised good or service” consistently within the new standard.
3	paragraph(s): 35(b)(iii)
	Suggestion: the entity expects to be entitled to the consideration for transferring control of promised goods or services <u>has a right to payment for performance-completed</u> to date and it expects to fulfil the contract as promised. The consideration for transferring control of promised goods or services <u>right to-payment for performance-completed</u> to date does not need to be for a fixed amount.
	Reason for suggestion: to align with the principle of the standard. I also suggest the boards to use the same wording for the same meaning to the extent possible and avoid the interpretation divergence, as people usually interpret the different wording as different meaning. For example, if the meanings of “has a right to payment” and “be entitled to the consideration” are same, the wording should be same.
4	paragraph(s): 35 (b) (ii)
	Suggestion: fulfil <u>satisfy</u> the remaining <u>performance</u> obligation
	Reason for suggestion: wording consistency.
5	paragraph(s): B16

	<p>Suggestion: provide-transfer the <u>control of specified-promised</u> goods or services itself (ie the entity is a principal) or to arrange for another party to provide-transfer the <u>control of</u> those goods or services (ie the entity is an agent)</p>
	<p>Reason for suggestion: wording consistency. See also No.2.</p>
6	<p>paragraph(s): IGA7 IE1</p>
	<p>Suggestion: The operator estimates that the costs it will incur to fulfil-satisfy its <u>performance</u> obligations will be</p>
	<p>Reason for suggestion: there is only performance obligation in this example.</p>
7	<p>paragraph(s): Overall</p>
	<p>Suggestion: As mentioned in the above comment “(5) Material right” and distinct (26(g), B21)”, I suggest the boards to clearly link application guidance to the requirement in the standard.</p>
	<p>Reason for suggestion: As application guidance is guidance for applying the principle in the standard, I think that it should be clearly linked to the requirement in the standard. I believe that to let people know clearly what principle application guidance is applying would help people better understand the new standard.</p>
8	<p>paragraph(s): Overall</p>
	<p>Suggestion: As mentioned in the above comment “(1) Each party or either party (paragraph 15, BC47)?”, when finalizing the standard, I suggest the boards pay attention to wording consistency between the standard and BC.</p>
	<p>Reason for suggestion: Although BC is not an integral part of the new standard, people tend to find clue to figure out the problem. Inconsistency between the standard and BC would cause a confusion and might lead to diversity in practice in accounting for revenue recognition.</p>