2011-230
Comment Letter No. 255

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

Institut der Wirtschaftsprüfer
in Deutschland e. V.

Wirtschaftsprüferhaus
Tersteegenstraße 14
40474 Düsseldorf
Postfach 32 05 80
40420 Düsseldorf

TELEFONZENTRALE:
+49 (0)211 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
+49 (0)211 / 454 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
Deutsche Bank AG Düsseldorf
BLZ 300 700 10
Kto.-Nr. 7480 213

Mr Hans Hoogervorst
Chairman of the
International Accounting Standards Board
30 Cannon Street

London EC4M 6XH
United Kingdom

Düsseldorf, 2 March 2012
540

Dear Mr Hoogervorst

Re.: IASB Exposure Draft 2011/6 "Revenue from Contracts with Customers" – *A revision of ED/2010/6 "Revenue from Contracts with Customers"*

We appreciate the opportunity to comment on the exposure draft mentioned above and would like to submit our comments as follows:

General Remarks

The IDW supports the decision to re-expose the proposals on revenue recognition, thereby avoiding unintended consequences. Moreover, we welcome that the revised proposals are aligned more closely with existing requirements.

However, we do not agree with the statement of the Board that the proposals in this exposure draft will improve the IFRSs by reducing the number of requirements (paragraph BC4). In comparison with the current requirements under IAS 18 and IAS 11, the proposed new standard on revenue recognition will be increasingly complex and rules-based.

We would like to comment on the specific questions as follows:

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB CPA;
Manfred Hamannt, RA

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

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?

The IDW agrees with the proposed requirements for determining when a performance obligation is satisfied over time. In comparison to the previous exposure draft, these proposals will result in a pattern of revenue that more faithfully depicts the performance of an entity under the contract.

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?

We concur with the Board's decision to exclude expectations of collectibility from the determination of the transaction price (if the contract has no significant financing component and/or a maturity of one year or less). This allows preparers to measure revenue generally at the invoice amount upon initial recognition, as is existing practice.

However, we do not support the proposal that any difference between the measurement of the receivable and the corresponding amount of revenue recognised shall be presented as a separate line item adjacent to the revenue line item.

- In our view, there is no need to require the presentation of a separate line item. Instead, the principles established in IAS 1 should apply. Hence, an entity should present an additional line item only when such presentation is relevant to an understanding of the entity's financial performance.
- Moreover, the difference between the measurement of the receivable and the corresponding amount of revenue should not be treated as an adjustment of revenue, since it is not directly related to the sale of goods, rendering of services and so on, but to the discrete activity of payment collection.

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

In order to avoid consequential amendments to the new standard on revenue recognition shortly after its publication, the Board should finalise the deliberations on the interaction with the impairment phase of the IFRS 9 project before issuing the new revenue standard.

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 recognises 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 recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

In our view, the amount of revenue recognised in the respect of variable consideration should be constrained. We appreciate that the proposed constraint is a qualitative threshold, rather than a quantitative threshold (paragraph BC201). However, how this constraint should be applied in connection with the specified requirements for determining the transaction price as stated in paragraph 55 is unclear. The following two different approaches are conceivable to determine the transaction price if the consideration is variable:

- Approach 1: As a first step, the transaction price has to be determined by using either the expected value or the most likely amount without considering the constraint. Subsequently, an entity has to assess whether it is *"reasonably assured"* to be entitled to the amount of consideration so determined.
- Approach 2: The *"reasonably assured"* constraint limits the range of possible consideration amounts that should be taken into account when determining the expected value or the most likely amount. This approach could be based on the explanation in the snapshot (compiled of the staff) that the term *"reasonably assured"* is a constraint that considers the quality of the information that an entity uses to estimate the amount of variable consideration.

The Board should clarify this issue.

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

In addition, the proposed guidance provides different interpretations of the term *"reasonably assured"* when there are factors outside the entity's influence:

- If an entity licences intellectual property in exchange for royalties based on the customer's subsequent sales of a good or service, the entity can only become reasonably assured to be entitled to the related variable consideration (i.e. the royalty payments) once those future sales occur (paragraph 85).
- By contrast, in case of a trailing commission received by an agent of an insurance company, the agent recognises commissions related to future policy renewals at the beginning of the arrangement because he can determine that he is reasonably assured to be entitled to the additional commission (example 14).

In our view, the proposed guidance is inconsistent and results in divergent outcomes for economically similar transactions. In both cases, the entity has no remaining performance obligations to fulfil and the additional future amount of consideration depends on the actions of third parties. However, in the first case additional revenue can only be recognised once uncertainty is completely resolved whereas in the second case revenue can already be recognised when the agent satisfies the performance obligation, even though the additional commission depends on the policyholder's uncertain behaviour in the future.

Paragraph BC203 states that paragraph 85 does not preclude an entity from recognising revenue in *all* circumstances in which factors outside the entity's influence exist. Thus, for circumstances other than those in paragraph 85, an entity should consider the indicators in paragraph 82 to determine the amount of consideration to which the entity is reasonably assured to be entitled. Nevertheless, it remains unclear whether (and to what extent) paragraph 85 could be applied by analogy in certain cases.

In our view, the IASB should re-deliberate the issue and provide consistent guidance.

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?

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

We do not support the proposals on onerous performance obligations for several reasons:

- The IDW believes that the unit of account for applying the onerous test should be the contract (rather than the separate performance obligation). An application of the onerous test at the level of each separate performance obligation would lead to the recognition of losses on separate performance obligations even if they are part of contracts that are profitable overall.

  The Board sets out that specifying the contract as the unit of account could be arbitrary because the unit of account would depend on whether the entity provides its goods or services in one contract or in more than one contract (paragraph BC207). In contrast, we believe that when the onerous test is based on contracts arbitrary recognition of losses is ruled out in most cases because two or more contracts shall be combined (according to paragraph 17) if they are negotiated as a package with a single commercial objective or if the amount of consideration to be paid in one contract depends on the price or performance of the other contract. Moreover, if the Board believes that the exposure draft does not provide adequate guidance on combining and segmenting contracts, it should address *this* issue rather than using this shortcoming as an argument for applying the onerous test at the level of separate performance obligations.

  Contrary to the Board, we believe that performing the onerous test at a contract level (as already required in other IFRSs, for example IAS 37) would <u>not</u> add complexity.

- The guidance on onerous performance obligations in the proposed revenue standard applies only to obligations that are satisfied over time. It does not apply to performance obligations satisfied at a point in time. Concurrently, the IASB proposes to amend IAS 37 such that rights and obligations that are within the scope of the proposed revenue standard would be outside the scope of IAS 37 except as specified by the proposed revenue standard and other standards (paragraph D21). According to paragraph 31 of IAS 2 and paragraph BC210 of the proposed revenue standard some provisions under IAS 37 may arise from "sales contracts in excess of inventory quantities held" (i.e. performance obligations satisfied at a point in time). All in all, it is not stated clearly and coherently in which cases provisions for onerous contracts / performance obligations are required pursuant to the proposed revenue standard and IAS 37, respectively.

- It is inconsistent that the proposals only address the accounting for losses on performance obligations that, at inception, are expected to be satisfied

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

over periods of time greater than one year. This could lead to the non-consideration of significant losses. Both performance obligations that are satisfied over time (irrespective of whether they will be satisfied over periods of time greater than one year or not) as well as performance obligations that are satisfied at a point in time could result in significant losses which should be completely recognised. In respect of immaterial losses, the materiality principle stated in IAS 1 should be sufficient to allay cost-benefit concerns for all kinds of contracts.

- There may be differences between the proposed revenue standard and IAS 37 in respect of the recognition and measurement of an onerous contract / performance obligation. For example, the IASB proposes to measure the liability based on the lowest cost of settlement to satisfy the performance obligation. This may differ from the amounts that entities currently consider when assessing the "unavoidable costs of meeting an obligation" under IAS 37. Furthermore, the IASB is silent on the question of whether a provision recognised for an onerous performance obligation should be discounted or not. The current guidance in IAS 37 requires the measurement of the liability at the present value if the effect of the time value of money is material. In our view, a single concept for recognition and measurement of onerous contracts / performance obligations in both standards is desirable, since the economic phenomena are similar. This would also ensure that IFRSs are internally consistent.

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)*

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

- *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 recognised from the costs to obtain or fulfil 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.

** In the IASB exposure draft, see paragraph D19 in Appendix D.*

Comments on the proposed disclosures in annual financial reports

The IDW agrees with the objective of the proposed disclosure requirements, i.e. to provide information about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Furthermore, we concur with the Board that specifying a disclosure objective could be useful to avoid the need for detailed and prescriptive disclosure requirements (paragraph BC246). We therefore wonder why some of the proposed disclosure requirements are nevertheless detailed and prescriptive. As examples, we would like to mention the disclosures relating to performance obligations (paragraph 118) and the determination of the transaction price and the amounts allocated to performance obligations (paragraph 127). In our view, both requirements would often lead to boilerplate statements and/or a proliferation of extensive and detailed information, at least in the case of global players. We concur with the alternative view put forward by Mr Engström, who also questions whether the benefits to users of the resulting disclosures would justify the costs that preparers would incur in providing these disclosures.

The proposed reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities (paragraph 117) is another example of extensive disclosures that will impose significant costs on preparers, as existing accounting systems are not designed to track and capture the necessary information.

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

Comments on the proposed disclosures in interim financial reports

We agree with the alternative view put forward by Mr Engström that the proposed amendment of IAS 34 is inappropriate and not justified. This proposal infringes on the general principle of IAS 34 which requires an entity to disclose only information about significant changes in its financial position and performance since the end of the last annual reporting period.

We support the alternative approach as described in paragraph BC273, specifying that an entity should disclose in interim financial reports

- a disaggregation of revenue and
- other disclosures only if that information significantly changes from period to period.

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?*

** In the IASB exposure draft, see paragraphs D17, D22 and D26 in Appendix D.*

The IDW agrees with these consequential amendments.

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

Other remarks

Finally, we would like to comment on some other aspects, partly re-iterating some concerns which we had previously mentioned in our comment letter on the *IASB ED/2010/6 Revenue from Contracts with Customers*, dated 13 October 2010:

- The **definition of a "contract"** as proposed in paragraph 13 and Appendix A differs from the definition in IAS 32.13. The IASB decided not to adopt a single definition of a contract for both IAS 32 and the proposed requirements, because the IAS 32 definition implies that contracts can include agreements that are not enforceable by law. Including such agreements would be inconsistent with the Boards' decision that a contract with a customer must be enforceable by law for an entity to recognise the rights and obligations arising from that contract. The IASB also noted that amending the IAS 32 definition would pose the risk of unintended consequences in accounting for financial instruments (paragraph BC32). In our view, the IASB should either adopt a single definition for the sake of internal consistency within the IFRSs or explain which agreements could be within the scope of IAS 32 without being enforceable by law.
- We doubt the usefulness of the second criterion of a ***distinct*** good or service, as stated in paragraph 28(b). Every asset can be used, consumed or sold by a customer. Even a resell for scrap value can provide benefit to a customer. So we do not see how this criterion could differentiate appropriately between items.
- According to paragraph B34, a **licence** represents a performance obligation that an entity satisfies at the point in time when the customer obtains control of the licence. It remains unclear whether a part of the entity's intangible asset should be derecognised when the customer obtains control and if so, how the related carrying amount of the intangible asset should be allocated between that part that continues to be recognised and that part that is derecognised. In this context, it might be necessary to distinguish between exclusive and non-exclusive rights (notwithstanding the Board's concerns mentioned in paragraph BC315).

IDW
INSTITUT DER WIRTSCHAFTSPRÜFER

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

Norbert Breker
Technical Director
Accounting and Auditing

Uwe Fieseler
Director International
Accounting