

# 中 华 人 民 共 和 国 财 政 部

MINISTRY OF FINANCE, PEOPLE'S REPUBLIC OF CHINA

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Mr. Hans Hoogervorst  
IFRS Foundation / IASB  
30 Cannon Street  
London, EC4M 6XH  
United Kingdom

12<sup>th</sup> March 2012

Dear Mr. Hoogervorst,

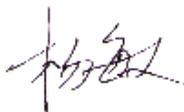
This letter is in response to the *Revenue from Contract with Customers ED*.

Thank you very much for providing the opportunity to China's Ministry of Finance and China Accounting Standards Committee to express our comments on the *Revenue from Contract with Customers ED*.

We deeply appreciated the efforts made by International Accounting Standards Board on establishing the Single-line Revenue Recognition Principle. Moreover, in the revised ED, we are delighted to see that comments from both theoretical and practical circles are extensively absorbed, the original vision has improved in various aspects. Meanwhile, it supplements with a more detailed application guidelines.

For more detailed feedback comments on the relevant issues of ED, please refer to the enclosed documents.

Sincerely Yours,



Ms. Yang Min,  
Director-General of the Accounting Regulatory Department of Ministry of Finance,  
China;  
Member of the China Accounting Standards Committee

**Annex:**  
Opinions on Revenue Standard of IASB

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 recognizes 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?

We think that the adjustment on the continuous transfer of control is one of the difficulties of applying the simple income recognition model based on control put forward by Exposure Draft. Paragraph 31 and 32 of Exposure Draft stipulate that an entity shall recognize the income when it transfers the control of goods or services; The control on goods or services refers to the ability of dominating the use of related assets and obtaining almost all of their benefits. However, it seems that the current statement of paragraph 35 and 36 does not completely start from this basic principle, but tries to use specific rules to include all situations that are possibly qualified. It will make the provision more difficult to understand, and easily result in different practices from the aspect of practice. Therefore, we suggest the Board to provide more clear principles and clarify the relationship of these principles and the definition of “control” in paragraph 32. As to some characteristics or signs that may be considered in applying these principles, they shall be distinguished from the basic principles.

One of key concepts that need to be further explained is “alternative use to the entity”. For example:

(1) Whether to consider the limitation of production capacity and production cycle? For example, for airplane manufacturers, because their products have characteristics such as high cost and long production cycle, they may not produce airplanes before clients place orders, their in-process airplanes may all have corresponding specific clients, and their production plans match closely to the delivery period of each client. In such situation, even airplane manufacturers produce highly standardized planes, such as Boeing 737 or 747, they cannot sell a plane it originally plans to sell to a client (e.g., A) to another (e.g., B) when considering the operational feasibility otherwise they will default to A, because their production plans match closely to the delivery to specific clients. Whether this limitation caused by the production capacity or production cycle belongs to “no alternative use to the entity”? Similar situations may also exist in the shipbuilding industry or other large equipments (e.g., trains and electric generators) manufacturing industry.

(2) Whether to consider whether a product of an enterprise has alternative use to itself when a client is defaulted? For large standardized products mentioned in the above paragraph, an enterprise may not have the ability to sell them to another client before the client cancels the order, but if a client defaults or cancels the contract with the enterprise, the finished product may be sold to others. Then whether an enterprise shall consider the situation of defaults of clients when it judges on the “alternative use to the entity”? For example, for ordinary commercial houses developed by real estate developers, when an enterprise presells commercial houses to clients in the developing stage of commercial houses, for example,

preselling Room 3 on the 15<sup>th</sup> floor to a client, then it cannot sell it to another before this client terminates the contract and returns the apartment. However, when the original client terminates the contract and returns the apartment, the enterprise may resell it to others.

Because the judgment of “alternative use to the entity” is the precondition of many enterprises on whether they can adopt the percentage-of-completion method, we suggest IASB to give further guidelines on which factors shall be considered or not be considered when making such judgment and provide some industry instances to help practitioners to understand the standards.

The following example of Chinese real estate developers means to explain the problems of the judging principle on continuous transfer of control (paragraph 35) of Exposure Draft that may occur in practice.

If judging that it meets “no alternative use to the entity” in accordance with paragraph 35 of Exposure Draft, the sale of commercial houses of real estate developers which adopt the presale system (sign the contract and collect the payment first, then deliver the house) is very likely to satisfy one of requirements of 35(b) (i), (ii) or (iii) so that it will be classified as “continuous transfer of control” and the income will be recognized with the percentage-of-completion method. Such result is very different from the current practice in China.

We think that the sales proceeds of commercial houses of Chinese real estate developers is more appropriately to be recognized at some time point as sales of goods rather than being recognized during a period as the ongoing performance obligation. The main reasons are:

(a) Clients are difficult to obtain the control on buildings under construction during the construction of real estate in China’s legal environment.

In accordance with paragraph 31-32 of Exposure Draft, an entity shall recognize related income when goods or services committed through transfer complete the performance obligations. Transferring a goods or service means that a client obtains the control on this goods or service, that is, the ability of dominating the use of related assets and obtaining almost all benefits of them. In fact, in China, the client really gets the control on the building he purchases only after the construction of a building is completed, the real estate developer receives the filing form of completion from related governments, the building is delivered for use and the client receives the property ownership certificate. When the building is under construction, the client cannot realize his control on the building or benefit from it.

(2) From the aspect of risk transfer, the risks related to the ownership of assets are not transferred before the actual delivery, and the recognition of income is largely uncertain.

Chinese real estate presale system uses the operating model of first signing the contract and making the payment then receiving the house. The presale contract will clearly stipulate that the building is qualified to be delivered only after it is completed and receives the filing of

completion. Before the delivery, the purchaser may choose to return the house conditionally (e.g., pay default penalty). Therefore, recognizing sales income before actually delivering the house may have great risk and is too radical.

(3) From the aspect of the operating model of Chinese real estate developers, what real estate developers provide are standardized goods and do not have the characteristics of customization.

Generally, Chinese real estate developers use the “Wal-Mart” operating model. Most commercial houses developed by them are same or similar in design or structure, like standardized goods. It clearly distinguishes them from “customized” commercial houses provided by European or American real estate developers. That is, China’s real estate development does not seek to meet the needs of a specific client and the products have wide adaptability. Before the real delivery, a client can return the house as long as it pays the default penalty. After that, the company can sell the house to new clients so it is difficult to determine that this house is customized for needs of contracted clients at the time of signing the contract and has no alternative use.

(4) From the aspect of the operability of practice, real estate developers are often difficult to reasonably estimate the progress of the engineering under construction.

In accordance with paragraph 41-44 of Exposure Draft, for every individual performance obligation fulfilled by an entity during a period, it shall choose one method to measure the progress of fulfilling this obligation and consistently use this method to recognize the income. The appropriate method of measuring the progress includes the output method and the input method. In fact, Chinese real estate developers often subcontract the engineering construction to building contractors, and they don’t directly control and grasp the real progress of the engineering. Therefore, the preparation cost of related information will increase and the manipulation of the profit of enterprises will be easier if it requires these developers to recognize income by period in accordance with the progress.

(5) From the aspect of engineering construction, Chinese real estate developers often subcontract the engineering construction to building contractors. That is, what the developers provide is building sales similar to common goods, and what building contractors provide is construction service based on the specific requirements of clients. Therefore, they should be different in accounting.

<p>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?</p>
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Disagree. We think that customer's credit risk shall be presented in expenses as loss from bad debts rather than being presented in income. The reasons are:

We think that customer's credit risk reflects the loss from bad debts resulting from recognizing revenue, which reflects the quality of assets rather than the initial recognized amount of revenue. It can also be taken that the amount of revenue belongs to the initial recognition and measurement of accounts receivable, and customer's credit risk belongs to the subsequent measurement of accounts receivable.

Moreover, if customer's credit risk is required to directly offset the revenue (even it is presented by items), shall financing income resulting from installment sale be separately presented? It will make the income statement include too much information and the information "overloading", which instead reduces the usefulness of the income statement. For example, a contract's cash flow is 120, the present value is 100, and initial recognized receivable is 100 (presented in statements); interest income subsequently recognized with real interest rate is 10, and now there is clear evidence that shows the entity can only receive 90 (present value). Then how to present the impairment, 20? Shall the enterprise recognize all of it as the deduction from income, or first reduce the interest income then recognize the balance as the deduction from income, or amortize it in proportion among the two items? Need the deduction from interest income be separately presented? For problems concerned by the Board, we suggest to solve them by explaining these problems in notes. From the actual situation of China, the disclosure in notes can well satisfy the information needs of users of statements such as investors and regulators.

In addition, paragraph 60 stipulates that an enterprise shall list the difference between the amount of receivables recognized in accordance with IFRS 9 and the amount of revenue recognized in accordance with the Revenue Standard as a separate item after the income item in current profit or loss. Recognizing the amount of receivables in accordance with IFRS 9 means that an enterprise shall recognize the receivables with fair value in the initial recognition, which may be different from the amount of revenue recognized in accordance with paragraph 49—52 of ED in the following aspects: (a) adjustment of client's credit risk; (2) changes of fair value of receivables caused by the difference between the market interest rate on the date of signing the contract and the market interest rate on the date of fulfilling the obligation.

We understand that separately presenting the above (1) is the purpose of the Revenue Standard, but how to deal with the impact of the above (2) needs the further explanation of the standards.

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?

We agree on the provision of IASB that the accumulated amount of the recognized revenue of an entity shall not exceed the amount that it can reasonably assure to have the right to obtain, but at the same time suggest it to give the further explanation and guidelines on the new concept “reasonable assurance”. We are not requiring IASB to give a quantitative criterion (e.g., must reach 70%), but suggest it to give a normal reference standard to reduce the difference in practices of enterprises and unnecessary disputes in the application of the standards.

In addition, for the situation that the consideration of intellectual property license may be changed because of the change of the subsequent sales income of clients, we think that it shall follow the principle of consistency and need not to make the exception handling different from the above principles.

Question4: 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 recognize 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?

Disagree. The reasons are:

First, the result from conducting the loss test in accordance with the performance obligation does not meet the economic reality, because generally an entity will negotiate on price based on the contract rather than the performance obligation. The basic measurement unit recognized with the performance obligation as revenue does not mean that the loss test shall be conducted on such basis, and what matters is the economic substance. In practice, the purpose of an enterprise to provide bound products and services with multiple components is to deal with the disadvantage of the weak anti-risk capability of individual component. If the Revenue Standard requires an enterprise to measure the profit or loss of an individual component, it will neither meet the characteristics of commercial behavior of enterprises nor reflect the operating characteristics of the composite products and services of enterprises.

Second, the contractual/performance obligations. Although paragraph 210 of the basis of conclusions mentions that such contracts shall be accounted for in accordance with related standards such as IAS 2—Inventories so that an enterprise still need to conduct the loss test, the main body of Exposure Draft has not any index, which is misleading because people may think that the loss test no longer applies to the contractual/performance obligations fulfilled at some time.

Third, the exemption of the performance obligation that is expected to be continuously performed within one year at the beginning of the contract. Different from the similar exemption of the time value of money, the length of time needed for performing the contract has no relation with whether the amount is important. For example, for a contract which begins from 1 December 2012 and is expected to end on 31 May 2013, its estimated loss is very huge. In accordance with the current standards, it will recognize the loss in 2012, which can be exempted according to the suggestion of paragraph 86. It will significantly reduce the quality of financial reports.

In a word, applying different loss tests caused by paragraph 86 of Exposure Draft because of different performance way of the contract (a period or a time point) or different lengths of time needed increases the complexity of the standards, which is confusing whether from the aspect of preparers of financial statements or users.

Therefore, we suggest maintaining the current method in IAS 37, which has been widely accepted by all parties and is clearly better than the method suggested by Exposure Draft.

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.

We think that the information of interim financial statements and annual financial statements that Exposure Draft requires to disclose is too much, so that there is risk of obscuring useful information by too much information requirement. The appropriate simplification or reduction of the disclosure requirement will better balance the intended use of users of financial statements and the burden of preparers of statements. Moreover, the current information disclosure requirement of interim reports proposed by the Board is inconsistent with the following principle: interim reports shall only reflect the significant changes from the last reporting period.

Therefore, we suggest the Board to make the overall consideration in its disclosure framework program in accordance with the objectives of accounting information disclosure, the cost-benefit principle and so on, and uniformly standardize them in IAS 34—Interim Financial Reporting to avoid the dismemberment of items of the standards.

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 derecognize the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognize 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 entity's ordinary activities? If not, what alternative do you recommend and why?

Agree.