

**Staff
Paper**

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Project	Revenue recognition	
Topic	Comment letter summary – main issues	

Purpose of this paper

1. This paper summarizes the feedback received in response to the boards’ exposure draft *Revenue from Contracts with Customers*, which was published for public comment in June 2010. The summary is based on the staff’s preliminary analysis of respondents’ comment letters as well as on feedback received from outreach activities undertaken by board members and staff members. (Agenda paper 3B / FASB memo 134B provides a summary of the outreach activities that have been undertaken on the revenue project.) A detailed analysis of feedback received on specific proposals in the exposure draft will be presented to the boards when redeliberations on those proposals commence.
2. This paper does not include any staff recommendations and the boards will not be asked to make any technical decisions at this meeting.
3. This paper should be read in conjunction with agenda paper 3C / FASB memo 134C, which proposes a plan to achieve the boards’ stated objective of issuing a joint revenue standard for US GAAP and IFRSs during 2011.

This paper has been prepared by the technical staff of the IFRS Foundation and the FASB for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

Comments made in relation to the application of U.S. GAAP or IFRSs do not purport to be acceptable or unacceptable application of U.S. GAAP or IFRSs.

The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

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Overview of the comment letters

4. The four-month comment period on the exposure draft ended on 22 October 2010. The boards received 986 comment letters which are summarized below by type of respondent and geographic region.

Respondent type	Number of respondents	Percentage of respondents
Preparers	481	49%
Individuals	173	18%
Auditors / accounting firms	102	10%
Users (including surety providers)	72	7%
Professional bodies	72	7%
Industry organisations	47	5%
Standard setters	18	2%
Regulators	7	1%
Academics	6	<1%
Consultants	5	<1%
Other	3	<1%
Total	986	100%

Geographic region	Number of respondents	Percentage of respondents
North America	726	74%
International	116	12%
Europe	73	7%
Asia	44	4%
Oceania	17	2%
Africa	6	<1%
South America	3	<1%
Unknown	1	<1%
Total	986	100%

5. Three factors help to explain the very high response rate to this exposure draft. First, revenue recognition has universal relevance to general purpose financial reporting. Consequently, it is not surprising that a diverse range of industries are well represented in the responses, including construction, manufacturing, telecommunications, technology, pharmaceutical, biotechnology, financial

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services, consulting, entertainment, energy and utilities, freight and logistics, and industries with significant franchising operations, such as hospitality and fast food restaurant chains. Some of the concerns raised by those respondents were specific to their industry, but many concerns identified were shared by respondents from a range of different industries.

6. Secondly, the very high response rate can be attributed to the revenue recognition project being an IFRS-US GAAP convergence project. This has also resulted in the comment letters being received from a geographically diverse range of respondents. In addition to the responses received from the FASB's constituents and the IASB's constituents from jurisdictions that have been using IFRSs since 2005 (such as Europe and Australia), responses were also received from:
 - (a) jurisdictions that are adopting IFRSs for the first time in 2010 or 2011, including Brazil, Canada and South Korea, or have plans to adopt IFRSs from 2012, such as India; and
 - (b) other jurisdictions that are in the process of making a decision to adopt IFRSs in the future, including Japan.
7. The relevance of the proposals—in terms of its application across industries and geographies—is evident from the high response rate from preparers as well as from the substantial number of responses from auditors, accounting professional bodies, national standard setters, and other interested parties including academics. Although responses from investors, equity analysts and securities regulators were limited, board members and staff focused some of their outreach efforts on those groups to ensure that their views can be included in the boards' redeliberations on the project.
8. Finally, a substantial number of comment letters seem to have been received in response to a question asked by the FASB on whether the boards' revenue recognition proposals should also apply to private entities in the US. Almost all of those responses were received from sections of the US construction industry that would like to retain existing construction contract accounting practices.

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Most of those comment letters were responses from private construction contractors, accounting firms that serve those contractors and surety providers¹ who use the financial statements of construction contractors when deciding whether to guarantee that those contractors will meet their obligations under a contract. The appendix to this paper analyses the responses from private entities in more detail. As such, the remainder of this paper does not specifically address issues raised only by those respondents.

Structure of the paper

9. The comment letters summary is presented as follows:
 - (a) Overall views (paragraphs 10 – 17)
 - (b) Recognition (paragraphs 18 – 54)
 - (i) Identifying the contract / price interdependence
 - (ii) Separate performance obligations
 - (iii) Control
 - (c) Measurement of revenue (paragraphs 55 – 75)
 - (i) Estimating the transaction price, including credit risk and time value of money
 - (ii) Allocation of the transaction price
 - (d) Onerous performance obligations (paragraphs 76 – 78)
 - (e) Contract costs (paragraphs 79 – 85)
 - (f) Disclosures (paragraphs 86 – 97)
 - (g) Effective date and transition (paragraphs 98 – 102)
 - (h) Application guidance (paragraphs 103 – 117)

¹ Surety providers are a user of financial statements, but they are not a primary user of financial statements because they can demand information from the entity.

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- (i) General comments
 - (ii) Product warranties
 - (iii) Licences
- (i) Consequential amendments (paragraphs 118 – 121)
 - (j) Other issues (paragraphs 122 – 126)

Overall views

10. With the exception of many of the responses that are discussed in further detail in the appendix, most respondents were generally supportive of the boards' efforts in jointly developing a single, comprehensive (and converged) revenue recognition model for US GAAP and IFRSs. Moreover, most respondents supported the core principle of that model, which is that an entity should recognise revenue when it transfers goods or services to a customer in the amount of consideration that the entity expects to receive from the customer.
11. Respondents acknowledged the progress made by the boards since the discussion paper, which presented only the basic building blocks of that model. The discussion paper introduced the concepts of a contract containing performance obligations for the entity to transfer goods or services to a customer and that revenue is recognised when the entity satisfies its performance obligations as a result of the customer obtaining control of those goods or services. The exposure draft refined those concepts and specified indicators of control and explained that an entity only needs to identify the separate performance obligations in a contract (ie the performance obligations to transfer to the customer goods or services that are distinct).
12. However, almost all respondents indicated that the boards need to further clarify the operation of those principles. In particular, respondents were concerned with the practical application of:

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- (a) the concept of control and the indicators of control to the service contracts and contracts for the continuous transfer of a work-in-progress asset to the customer; and
 - (b) the principle of distinct good or services for identifying separate performance obligations in a contract. Many respondents were concerned that the principle, as currently drafted, would like to inappropriate disaggregation of the contract.
13. Many of the respondents are concerned that those proposals as written could be difficult to apply consistently across a wide range of industries and may produce accounting outcomes that do not faithfully portray the economic substance of the entity's contracts with customers and the entity's performance under those contracts. Those respondents were concerned that the boards' objective of comparability of revenue recognition across industries might only be achieved at the cost of losing the current levels of comparability in the revenue recognition practices within each industry. Consequently, some of those respondents suggest that the boards might need to develop industry specific guidance or create industry-specific exceptions to the general principles. For construction contracts, many respondents from the construction industry suggested that their contracts are sufficiently different from other contracts with customers to justify a separate standard.
14. Because of those concerns, many respondents have queried whether the exposure draft provides a compelling case for change from existing revenue standards that, in their opinion, meets the needs of users as well as management. Those respondents are concerned that applying the proposed requirements would impose costs on preparers in excess of the (conceptual) benefits of having a single revenue recognition model applying equally to all contracts with customers. Part of the concern regarding whether the proposed model is cost-beneficial relates to the other changes to existing practices that are proposed in the exposure draft, including:

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- (a) estimating the transaction price on a probability-weighted average basis and including credit risk and the time value of money in that estimate;
 - (b) accounting for contract modifications on a cumulative catch-up basis;
 - (c) recognising an expected loss on a performance obligation that is onerous;
 - (d) recognising product warranties for latent defects as 'failed sales' rather than as cost accruals; and
 - (e) the disclosure of the reconciliation of contracts balance and the amount and timing of outstanding performance obligations.
15. Although both boards' constituents queried the case for change, the FASB's constituents seemed to be least convinced of the case for change. This reflects developments in US GAAP recently with the:
- (a) Accounting Standards Codification (ASC) organising and co-locating all the revenue guidance in US GAAP; and
 - (b) improvements to US GAAP in accounting for multiple element arrangements as a result of the amendments to Subtopic 605-25 made by Accounting Standards Update No. 2009-13 *Multiple-Deliverable Revenue Arrangements*.
16. In contrast, there is an acknowledgement that improvements can be made to IFRSs because of the limited guidance and the gaps in that guidance. However, some of those respondents questioned whether the proposals in the exposure draft represent a meaningful improvement to the existing revenue recognition requirements in IFRS.
17. Finally, several respondents applauded the boards and staffs for their efforts to reach out and engage with preparers, users and auditors in the lead up to, and following the publication of, the exposure draft. However, because of the importance of revenue recognition to financial reporting, some respondents have recommended that the boards should not rush re-deliberations on the project and that, prior to issuing a final standard, the boards should:

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- (a) conduct additional testing of the completed model; and/or
- (b) re-expose the proposals for further public comment.

Recognition

Identifying the contract / price interdependence

18. The exposure draft explains that, in most cases, an entity would apply the proposed requirements to a single contract. However, in other cases, the boards proposed that the principle of ‘price interdependence’ should determine whether:
- (a) to combine two or more contracts and account for them as a single contract;
 - (b) to segment a single contract and account for it as two or more contracts; and
 - (c) to account for a contract modification as a separate contract or as part of the original contract.

Price interdependence

19. Several respondents considered that price interdependence should be an indicator, rather than a determinative factor, for combining or segmenting contracts. Many of those respondents suggested that a decision to combine or segment contracts should be based on a broader notion of *economic* interdependence or *functional* interdependence. They consider that interdependence may also arise from the interrelationship of other factors such as risk or the degree of functionality between the good or services being provided in a contract or among two or more contracts.

Combining contracts

20. Respondents generally agreed with the proposal to combine contracts if those contracts are interdependent. However, a few respondents commented that it could be difficult to determine whether a discount offered on one contract arises

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because that contract and another contract are interdependent (in which case, the contracts should be combined) or because the discount relates to an existing customer relationship (in which case, the contracts would not be combined). They added that making that distinction would be particularly difficult for entities that negotiate contracts individually rather than enter into contracts with standard terms.

21. A few respondents were concerned that a requirement to combine all contracts that are interdependent could be unnecessarily complex in situations where a product is sold at a discount in anticipation of future sales of related goods or services (eg a razor is sold at a discount in anticipation of future sales of replacement razor blades). Combining contracts in those situations would result in the entity adjusting the accounting for that initial contract each time the customer enters into subsequent contract that is subject to the interdependency. To avoid that outcome, a respondent suggested that separate contracts should be combined only when it is sufficiently certain that, on entering into the first contract, a second contract with the same customer will follow.

Segmenting contracts

22. In the exposure draft, the boards' proposed that an entity should segment a contract into separate contracts (based on a principle of price interdependence/independence) and then identify separate performance obligations within each of those contracts (based on the principle of distinct goods or services). The exposure draft explains that a contract segmentation principle is useful in an allocation model because it effectively 'ring fences' the customer consideration that is attributed to underlying goods or services that are independent from other goods or services to be provided under the contract. Consequently, any discount or changes in the customer consideration that is attributable to those items would only affect the transaction price of that contract segment.
23. Most respondents commented that the need for a contract segmentation principle was not well explained in the exposure draft. Furthermore, they argued that

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specifying two steps for dividing a contract into components would be cumbersome and confusing, and potentially would be unnecessary.

Respondents suggested that the boards could simplify the exposure draft by:

- (a) eliminating the proposed requirement to segment a contract so that an entity would only unbundle a contract if that contract comprises separate performance obligations;
- (b) allocating a discount offered on some goods or services or changes in the amount of the transaction price only to the separate performance obligations to which those amount relate.

24. Respondents' views on separate performance obligations are discussed further in paragraphs 28-44 below.

Contract modifications

25. Many respondents suggest that the exposure draft has not clearly articulated and correctly identified which contract modifications change the existing terms and conditions of a contract (and should be accounted for retrospectively on a cumulative catch-up basis) and which contract modifications create a separate contracts (and therefore should be accounted for prospectively). Those respondents consider that the proposed requirements for contract modifications are not operational because:

- (a) 'price interdependence' is not a suitable principle for determining whether to account for a contract modification as a modification to an existing contract or as a separate contract because:
 - (i) the principle is ambiguous—as one respondent remarked, “it would be difficult to see when a modification would be independent of the original contracts as, by its nature, the modification relates to the original contract” (CL #419); and
 - (ii) as a result, the principle might require some contract modifications to be accounted for on a cumulative catch-up basis in the period in which the modification occurs

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even though the modification only relates to the remaining performance obligations in the contract. Conversely, the principle might require some modifications to be accounted for separately even though they relate to the original contract (eg change orders in construction industry);

- (b) insufficient guidance is provided for classifying and accounting for common types of contract modifications, such as:
 - (i) whether unpriced contract change orders that are expected to be approved by the customer can be treated as a contract modification; and
 - (ii) whether the subsequent exercise of contractual options that do not qualify as a material right at contract inception should be treated as a separate contract;
- (c) the example illustrating the accounting for contract modifications (example 2) seems to contradict the proposed principle in the exposure draft.

26. In addition, a few respondents, especially those from the telecommunications industry, expressed concerns that they would encounter practical difficulties in accounting for contract modifications on a cumulative catch-up basis because their industry is typified by large populations of contracts and with large numbers of contract modifications. They also explained that most modifications to their contracts relate to changes to future goods or services to be delivered under the contract rather than changes to the overall terms and conditions of the contract. Consequently, they believe that accounting for those contract modifications on a prospective basis would provide a better reflection of the underlying economics of the arrangement.

27. Respondents have suggested that the boards should address those concerns by:
- (a) providing guidance that classifies different types of contract modifications and specifies whether to account for those modifications prospectively or retrospectively; or

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- (b) permitting the use of management judgement to determine whether, according to the facts and circumstances, prospective or cumulative recognition of the contract modification best reflects the economics of the modification.

Separate performance obligations

- 28. In the exposure draft, the boards proposed that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is *distinct*. The proposal generated a lot of comment, with many respondents commenting that the concept of identifying separate performance obligations is an improvement to the proposals in the discussion paper, which most commentators interpreted as proposing that an entity should account separately for each performance obligation in a contract.
- 29. The exposure draft also proposes criteria to specify that a good or service is distinct if:
 - (a) the entity or another entity sells an identical or similar good or service separately; or
 - (b) the entity could sell the good or service separately because it has a distinct function and a distinct profit margin.
- 30. A majority of respondents agreed with using the principle of ‘distinct goods or services’ to identify separate performance obligations in a contract. However, most of those respondents also commented that the criteria accompanying the principle need to be refined because they imply that ‘distinct’ would still require a very granular level of accounting for performance obligations.
- 31. Different views were expressed for identifying the goods and services that are distinct. Suggestions included:
 - (a) employing a top-down rather than bottom-up basis for identifying which goods or services are distinct; or

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(b) focusing on the perspective of the customer rather than the entity. For example, to separately identify only those goods or services that a customer is seeking to acquire from the entity.

32. The feedback received from respondents on each criterion is summarised below.

Sold separately

33. Respondents generally agreed that a good or service is distinct if it is sold separately by the entity. However, a few respondents suggested that this criterion should be limited to include only those goods or services that are provided in an entity's ordinary course of business.
34. Fewer respondents agreed that a good or service is distinct if it is sold separately by another entity. Those respondents were concerned that, because most goods or services are sold separately by another entity (eg a competitor, a supplier or a manufacturer), this criterion could result in excessively granular accounting for separate performance obligations. In addition, some queried how much investigation an entity might need to undertake to determine whether a good or service is sold separately. For instance, would a domestic retailer be required to ascertain whether a good is sold separately in the wholesale market or in the retail market in another country?
35. If the entity does not sell the goods or services separately, the boards proposed that the goods or services should be regarded as distinct only if they have a distinct function and a distinct profit margin (see paragraph 23(b) of the exposure draft). The following paragraphs discuss respondents' views on those criteria.

Distinct function

36. Respondents generally agreed that a good or service would be distinct if it has a 'distinct function'. However, respondents suggested that the boards might need to provide additional guidance to complement the criterion so that it is applied consistently. This is because some respondents were concerned that the proposed requirement that a good or service has a distinct function could be

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interpreted very broadly because almost any element of a contract could be argued to have utility in combination with other goods or services.

37. The principle of a distinct function could be limited by including only deliverables that are substantive (ie deliverables that have standalone value to the customer and are not incidental). For instance, one respondent commented

the test of whether a performance obligation is distinct should focus only on whether, in practice, the good or service would have stand-alone value to the customer, because that customer could in practice use that good or service in conjunction with other goods or services that are genuinely available to such a customer. (CL #393)

Distinct profit margin

38. Most respondents stated that the 'distinct profit margin' criterion was confusing. For instance, respondents commented that:

- (a) the existence of distinct margins may not always indicate that goods or services are distinct because:
 - (i) entities may decide to assign the same margin to various goods and services even though those goods or services use different resources and are subject to different risks;
 - (ii) for some goods or services, especially for software and other types of intellectual property, cost is not a significant factor in the determination of price and so margins may be determined by the customer's ability to pay or obtain substitute goods or services from another entity;
- (b) the distinct profit margin principle seems circular because a profit margin requires a selling price and a price would be attributed to the good or service only when it is determined to be distinct; and
- (c) it is difficult for sellers to know whether a good or service has a distinct profit margin if the entity does not actually sell the good or service separately.

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39. Some respondents recommended that the boards should instead refer directly to ‘distinct risks and resources’ as the criterion rather than to continue to use that phrase to describe a ‘distinct profit margin’. Under that approach, respondents suggested the boards to clarify whether:
- (a) resources are distinct only if they are sufficiently different in nature (eg different raw materials, processes, skills or locations); or
 - (b) resources are distinct if the underlying activities are capable of being performed independently.
40. Respondents from the software industry suggested that the exposure draft should clarify that a distinct profit margin exists if an entity can reasonably estimate the selling price of the good or service, despite the fact that specific resources (such as programmers) are used for multiple goods or services. That is because, as one respondent explained, intangibles such as software and related post contract support services often have very high margins and so cost may not be the primary consideration for establishing the price of that good or service. Consequently, using distinct margin to identify separate performance obligations may not reflect the economic substance of those transactions.
41. However, other respondents also commented on the suitability of referring to risks to determine whether a good or service is distinct. For instance:

The AASB does not agree with the reference to risk in paragraph 23(b)(ii). The proposals could have concluded that ‘distinct’ relates to an identifiable profit margin with no reference to risk. Reference to risk adds confusion and the AASB does not agree that different profits in a contract necessarily equates to different risks in a contract. Two similar products could have the same risk but different margins due to supply and demand or synergies available to particular suppliers that enable them to generate higher margins without a commensurate increase in risk. The AASB recommends that this reference to risk is removed. (CL #934)

Construction contracts

42. Respondents from the construction industry commented that their construction contracts almost always consist of only one performance obligation. For example:

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...for many long-term contracts in our Industry, the deliverable is the entire project, and the various activities comprising these projects are performed in an overlapping, concurrent or highly interrelated manner, such that, given the interdependencies, the activities do not have separate utility or risks and therefore, do not have a distinct function or margin. In their simplest form, the long-term contracts in our Industry often contain only one performance obligation: a single project designed and built to the project owner's specifications. (CL #260)

43. Those respondents were concerned that the criteria for distinct goods or services would require a construction contract to be treated as a series of separate performance obligations for each good or service in the contract that could be sold separately (eg for any part of the contract that could be undertaken by a subcontractor). They commented that this accounting is inconsistent with the boards' stated intent on not requiring the identification of separate performance obligation when the underlying goods or services are highly interrelated and are subject to inseparable risks. To overcome that concern, many of those respondents suggested that the discussion on a contract management service in example 11 and in the basis for conclusions should be more clearly reflected in the separation principle in the proposed standard.

Other issues

44. In addition, some respondents also asked the boards to consider whether the following obligations would be recognised as separate performance obligations:
- (a) constructive obligations that might not always be legally enforceable (eg when-and-if upgrades);
 - (b) performance obligations that are perfunctory or incidental; and
 - (c) performance obligations that are contingent on a future event that is outside the control of the entity or the customer (eg manufacturing services for a to-be-developed drug that is contingent of regulatory approval being provided).

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Control

45. The concept of control underpins the recognition of revenue. In the exposure draft, revenue is recognised when the customer obtains control of a promised good or service. Control of a good or service is assessed from the customer's perspective and the customer obtains control when it has the ability to direct the use of and receive the benefit from the good or service. The exposure draft lists four indicators of control.
46. Most respondents commented that the boards need to improve the principle for determining when goods or services are transferred to a customer. Some respondents disagreed with using 'control' to determine when to recognise revenue. In general, there was a concern that the term is too theoretical and could be interpreted as passing to the customer only when legal title passes. There was also a concern that the meaning of control for revenue recognition purposes might become confused with the meaning of control for accounting for subsidiaries and other investments.
47. As an alternative to a control model, some respondents suggested that revenue should be recognised when:
 - (a) risks and rewards transfer to the customer or when the entity has reached the culmination of the earnings process. Respondents supporting this view did not agree with the boards' conclusions in paragraph BC60;
 - (b) an entity undertakes activities in order to satisfy its performance obligations under a contract with a customer (ie activities model); or
 - (c) an entity undertakes activities in order to satisfy its performance obligations under a contract with a customer *and* the entity has established an irrevocable right to consideration for work carried out to fulfil that contract.
48. Other respondents broadly agreed with the concept of control but requested that the boards clarify how to evaluate control. Respondents generally agreed that

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the proposals apply appropriately to determine when control of a good passes to a customer. However, respondents requested clarification on evaluating control for service contracts in which there is no tangible underlying assets (eg transportation, consulting, and software development) and for construction contracts. Those respondents commented that:

- (a) the definition of control needs improvement because the ‘use and benefit from’ notion does not resonate for services and for partly completed assets; and
- (b) the indicators of control proposed in the exposure draft either do not apply to services or cannot be readily applied to services.

Service contracts and continuous transfer

- 49. Respondents stated that the customer would obtain control of services continuously for most service contracts. However, some explained that it could be challenging to apply the control model to service contracts for an ‘end product’ (eg the creation of database tailored to the specific needs of a customer).
- 50. Respondents commented that the control concept might have to be able to distinguish between two types of service contracts:
 - (a) services that transfer to the customer continuously because the customer obtains the benefits from the services as the services are rendered by the entity;
 - (b) services that transfer to the customer at a discrete point in time (eg at completion of an audit report).
- 51. A respondent suggested that the boards could include a rebuttable presumption that continuous transfer exists for a service unless there is evidence to the contrary. Alternatively, it was suggested that the boards include supporting guidance to emphasise that services normally transfer to the customer continuously as the required activities are performed or the service adds value to the customer.

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52. A respondent also suggested that the boards specify that a continuous transfer contract is a contract in which the customer obtains control of the work-in-progress in its current state as the work is performed.

Indicators of control

53. Comments on the indicators listed in the exposure draft included:

Indicator	Comments
The customer has an unconditional obligation to pay	<p>This indicator may be too restrictive because the customer will often have an unconditional obligation to pay only once the entity has satisfied most of its obligations.</p> <p>This indicator also creates tension with the guidance on non-refundable upfront fees (which shows situations in which nothing has been transferred even though the customer has paid).</p>
The customer has legal title	<p>Legal title is an enabler for the exercise of control (over goods) rather than an indicator of control.</p> <p>This indicator has little relevance to the control of service.</p> <p>Some respondents commented that the transfer of risks and rewards of ownership should be included as an indicator of control to discourage entities from structuring the legal form of transactions and contracts to achieve desired accounting outcomes.</p>
The customer has physical possession	<p>Similarly, physical possession is an enabler or mechanism for the exercise of control (over goods) rather than an indicator of control.</p> <p>This indicator has little relevance to the control of service.</p>
The design or function of the good or service is customer specific	<p>Views on this indicator were mixed. The indicator was viewed either as critical to the assessment of whether a customer obtain control of a good or service (eg for construction or engineering projects undertaken by the entity at the direction of the customer) or as inappropriate to the assessment of control (eg for real estate developments in some parts of the world whereby some respondents consider</p>

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	<p>that the local laws and contractual terms enable the customer to obtain control of a part completed apartment even though the customer has limited input into the design and function).</p> <p>In addition, some respondents consider that design has no direct bearing on the transfer of control. Rather, the fact that the design or function of a good is customer specific provides an incentive for the supplier to negotiate terms that either result in control being transferred as work is performed or that require the customer to make advance payments or offer guarantees to the supplier. Those respondents also state that using an indicator relating to the customer's ability to specify changes to the design or function confuses obtaining control of the current work-in-progress with re-specifying the work to be done in the future.</p>
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54. Some respondents also requested additional guidance on how to use the indicators to determine when a customer obtains control of a good or service.

That guidance could include:

- (a) specifying the relative importance of individual indicators, especially if there are conflicting indications on whether the control has passed to the customer;
- (b) specifying whether it is sufficient to conclude that control has passed to the customer when a specific indicator or a pair of indicators is present.

Measurement of revenue

55. In the exposure draft, the boards proposed that the transaction price should reflect the probability-weighted amount of consideration that an entity expects to receive from the customer in exchange for transferring goods or services. In addition, the boards proposed that revenue should be recognised at the amount of the transaction price that:

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- (a) includes customer consideration that is variable in amount only if those amounts can be reasonably estimated;
- (b) reflects the customer's credit;
- (c) reflects the time value of money if the contract includes a material financing component.

Probability-weighted amounts of customer consideration

56. The majority of respondents disagreed with the use of expected value measurement techniques to estimate the transaction price of a contract with a customer unless that contract formed part of a portfolio of homogeneous contracts. In all other cases, respondents would prefer to use management's best estimate of the transaction price, which staff understands to be the single most likely outcome. Respondents objected most strongly to the use of expected value measurements of the transaction price when the associated probabilities of receiving the consideration have a binary outcome (eg all or nothing). In those cases, they did not think that recognising revenue at an amount that the entity could not receive would provide meaningful information. Several respondents said that they also disagree with the boards' use of expected value measurement techniques in other standards.

Reasonable estimates of the transaction price

57. As a general observation, respondents seem to agree with constraining estimates of variable consideration to include in the transaction price. However, respondents expressed mixed views on the boards' proposal to restrict variable consideration from the measurement of revenue to situations where the entity (or another entity) has relevant past experience with similar contracts. Some respondents commented that the boards' proposal would impose too high a hurdle in a situation where the entity (or other entities) has no experience but there is minimal variability in the transaction price and minimal uncertainty as to collectability. For example, this could arise with a new product or service.

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Those respondents argue that the criteria in paragraph 38 of the exposure draft creates a rule that constrains and potentially negates that principle that variable consideration is included in the transaction price only if it can be reasonably estimated.

58. Other respondents (including respondents from the media and entertainment industries) were concerned that the boards' proposals would allow revenue to be recognised prior to the amount of variable consideration becoming certain. They were concerned that the boards' proposals would require entities to 'true-up' their estimate of the transaction price on an ongoing basis. They suggested that estimates of transaction price should be subject to a probability threshold that is higher than a 'reasonable estimate'.

Royalty type arrangements

59. Some respondents commented that an estimate of the transaction price should not include amounts of consideration where the variability is within the control of the customer. This may occur with some arrangements in which the entity receives a royalty based on the level of sales made by a customer. Those respondents hold that view even though the entity may be able to use historical data to reasonably estimate of the royalty revenue it will receive. Those respondents argue that the estimation of the transaction price should distinguish between variability of consideration that is within the control of the customer and variability that is outside the customer's control.

Telecommunications contracts

60. Most respondents from the telecommunication industry have objected strongly to the boards' revenue recognition proposals at the discussion paper and exposure draft stages. In responding to the proposals contained in the exposure draft, one of their main concerns was that the transaction price that is allocated to the goods or services in a telecommunications contract should be limited to the amount that is not dependent on the future provision of services to the customer. This is often referred to as the contingent revenue cap. Under that

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approach, revenue would be recognised on transfer of a handset to the customer at the amount that the customer paid for the handset at contract inception. The remaining contractual payment would be recognised subsequently as the entity provides network services to the customer. The following comment explains that concern in further detail:

This concern relates to the proposed reallocation of ongoing service revenue to the device we provide to customers to allow them to access our service. According to the proposed model reallocated revenue would be recognised upfront, in advance of the provision of service and customer billings. Additionally, as a result of this “reallocation” assets would be recognised which are (1) not legally enforceable if we, as an operator, do not fulfil our contractual obligations to provide future services to the customer and (2) measured at varying values without relation to the future economic benefits they may represent. We have strong doubts whether the model proposed in the Exposure Draft will ultimately improve the quality of information provided in financial statements. (CL #182)

Credit risk

Including credit risk in the measurement of revenue

61. Most respondents disagreed with the boards’ proposal to reflect customer’s credit risk in estimating the transaction price, and therefore in measuring how much revenue an entity recognises when it satisfies a performance obligation. They commented that revenue should be recognised at the amount of the transaction price that equals the contract price. However, a few respondents commented that an exception to that principle should apply if:
- (a) the entity adjusted the contract price for a specific customer to reflect that customer’s credit risk—in that case, they suggest that revenue should be recognised at the amount that is net of the credit risk adjustment; or
 - (b) it is not reasonably assured that the customer will pay—in that case, they suggest that no revenue should be recognised unless and until it is probable that the customer will pay.

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62. Respondents raised the following concerns with including credit risk in the measurement of revenue:
- (a) The proposal significantly changes existing accounting practice for doubtful / bad debt provisions that are well established and accepted by users and preparers.
 - (b) It might be difficult and impractical to establish credit risk for individual customers. Moreover, even though the exposure draft implies that the transaction price is adjusted for credit risk only when that risk is material, the net effect of accounting for credit risk for a contract when it is individually material would be different compared to existing practice which would recognise a provision for doubtful debts by assessing the portfolio of contracts for credit risk.
 - (c) Revenue recognised under the proposals may not reflect the amount invoiced to the customer or the amount of consideration received from the customer. Many respondents remarked that a credit loss does not imply a failed sale and accordingly a customer's credit risk should not affect revenue so long as the entity has fulfilled its performance obligations under the contract.
 - (d) The proposal would add complexity to the accounting for contracts with customers. Systems changes would be necessary to account for credit risk for individual customers and there may be a lack of objective evidence to audit the financial reporting that results from the requirement.
 - (e) Users of financial statements prefer to have information on gross or contractual revenue with (subsequent) credit losses reported separately.

Accounting for changes in the estimate of customer credit risk

63. Almost all respondents disagreed with the proposal that initial assessments of credit risk would affect revenue and subsequent changes in the assessment of credit risk would be recognised as other income or expense. Respondents

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argued that if the boards decided that customer credit risk should affect the measurement of revenue, then any subsequent changes in the assessment of that risk should also affect revenue. Respondents were concerned that under the boards' proposals there would be 'lost' revenue if a customer eventually pays the full invoiced amount because the difference would be reported as 'other income'.

Time value of money

64. Most respondents agreed with the conceptual rationale for adjusting the transaction price for the effect of the time value of money. However, many of those respondents queried whether the benefits of accounting for the time value of money justify the complexity, particularly in cases in which the customer prepays. Some respondents remarked that it was unclear how the boards intended the proposal would:
- (a) apply to multiple element arrangements—one respondent explained that applying the proposal strictly might require the entity to use simultaneous equations to estimate and allocate the effect of time value of money to the separate performance obligations in the contract; and
 - (b) distinguish implicit financing in multi-year contracts from upfront payments that are used as a deposit to protect against non-payment and other contractual disputes.
65. Alternative approaches for accounting for the time value of money that were suggested by respondents include:
- (a) only requiring the transaction price to be adjusted for the time value of money when it has been explicitly agreed that there is a financing component within the relevant agreement;
 - (b) exempt 'normal business practice' (eg subscription services that are typically paid in advance);

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- (c) specifying a minimum period (eg one year) when time value of money does not need to be accounted;
- (d) distinguishing between payments from customers that are received in advance (not a financing activity) and payments from customers that are received in arrears (a financing activity); and
- (e) specifying that a material financing is evaluated at the contract level rather than at the portfolio or entity level.

Allocation of the transaction price

66. In the exposure draft, the boards proposed that the transaction price should be allocated to separate performance obligations in proportion to the standalone selling prices of the underlying goods or services at contract inception. After contract inception, any changes in the transaction price should be allocated to all performance obligations on the same basis as at contract inception.
67. Most respondents broadly agreed with the boards' proposal as a starting point for allocating the transaction price. However, they argued for a more principled approach to deal with:
- (a) allocating contract discounts or subsequent changes in the transaction price that only belong to part of the contract; and
 - (b) allocating the transaction price to goods or services that do not have an observable standalone selling price.

Allocating discounts and subsequent changes in the transaction price

68. Many respondents disagreed with the view expressed in the exposure draft at paragraph BC127 that any discount in a contract is attributable to the contract as a whole and should be allocated proportionally to the separate performance obligations in the contracts. They explained that, for bundled offerings of high margin and low margin items, vendors may grant a discount on the high margin items to entice a customer into a sale. Consequently, a proportionate allocation of a discount would allocate too much discount to the low margin items and too

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little discount to the high margin items. As a consequence, the allocation would fail to faithfully portray the economic substance of the transaction—in terms of the amount of revenue that is recognised when those items transfer to the customer. Furthermore, the allocation could result in the entity recognising an onerous performance obligation for the low margin items.

69. For that reason, some respondents suggested that the transaction price should be allocated on the basis of margins rather than stand-alone selling prices.
70. Other respondents suggested that the boards should allow flexibility in the allocation of the transaction price so that contract discounts can be allocated to goods or services to which the discount relates. One respondent suggested that management should be permitted to use another basis for allocating discounts only when the general principle would “allocate excessive discounts to an item (or items), such that the allocated amount is lower than the ranges of prices for which [the item] is sold would be sold”.² Many respondents explained that permitting flexibility in the allocation of these types of discounts also lessens the need for contract segmentation to be treated as a separate step in applying the proposed model. (This was discussed earlier at paragraph 23(b).)
71. Many respondents also suggested that a similar approach should apply to allocate subsequent changes in the transaction price. Similar to the earlier comments on accounting for contract modifications, those respondents explained a change in the transaction price may be attributable to factors that relate only to some goods or services in the contract. Therefore, allocating that change to all performance obligations – including performance obligations that have already been satisfied – may not reflect the substance of the change.
72. In addition, respondents explained that the boards’ proposals for allocating the transaction price would not permit an entity with fee-based investment management contracts or hotel management contracts to recognise revenue for performance to date. With those types of contracts, the customer consideration

² See CL# 393A

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is payable periodically throughout the life of the contract at amounts that are based on the entity's performance for that period. Because the entity's performance in future periods cannot be reasonably estimated, the transaction price that can be allocated to the entity's performance obligation is limited to the amount of customer consideration that is payable to date.

Alternatives to estimating standalone selling prices

73. Some respondents expressed concerns with allocating the transaction price on the basis of standalone selling prices that cannot be reliably determined because either:
- (a) there are no observable standalone selling price for the good or service;
or
 - (b) there are a wide range of historical prices the entity has been willing to sell a good or service for.
74. Many of those respondents suggested that the boards should instead permit or require the use of residual measurement techniques to allocate the transaction price in those cases.³
75. Some respondents were also concerned with the practical difficulties in identifying standalone selling prices for a large number of distinct goods or services. Some of that concern can be attributed to those respondents being concerned that the exposure draft would require the entity to identify separate performance obligations at a granular level.

³ In the residual method, remaining performance obligations (or items) in an arrangement are measured using objective and reliable evidence of selling prices of those items. Any difference between that measurement and the total transaction price is recognised as revenue for the delivered items.

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Onerous performance obligations

76. Almost all respondents disagreed with the boards' proposal to recognise a liability for an onerous performance obligation. The concerns raised by respondents relate to:
- (a) the outcome—most respondents were troubled that an onerous performance obligation could be recognised even though the contract as a whole is profitable. They considered that such a result would be counterintuitive, artificial and misleading to a user.
 - (b) the design of the proposed model—some respondents commented that a performance obligation sometimes could be onerous because of the interactions with other proposals in the model, such as:
 - (i) identifying as separate performance obligations goods or services that are priced interdependently;
 - (ii) allocating discounts within a contract on a relative standalone selling price basis; and
 - (iii) excluding variable consideration from the estimate of the transaction price if it cannot be reasonably estimated;
 - (c) practical application—some respondents commented that contract costs may not be tracked at the performance obligation level. Therefore the allocation of costs to individual performance obligations and the assessment of whether those performance obligations are onerous could take considerably more time and effort than making an assessment at the contract level.
77. Respondents suggested that the test for onerousness generally should be performed at a contract level, consistent with existing practice for construction contracts in IAS 11 and ASC Subtopic 605-35. However, for some contracts, a respondent suggested that to better reflect the underlying economics of the transaction, the onerous assessment may need to be performed at a higher level than the contract when the entity obtains benefits beyond the individual contract. For some contracts, this might be at the customer relationship level (eg for

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aircraft engines and subsequent servicing contracts). For other contracts, this might be at a portfolio of contracts level (eg for airline seats).

78. Finally, some respondents regard provisions for onerous performance obligations to be cost accruals and they suggested that the requirements should be addressed in the relevant liability or contingency standards.

Contract costs

79. In the exposure draft, the boards proposed that:
- (a) the costs of obtaining a contract (ie contract acquisition costs) would be recognised as expenses when incurred; and
 - (b) the costs incurred in fulfilling a contract that are not eligible for capitalisation in accordance with other standards (eg as inventory or as property, plant or equipment) would be recognised as an asset if those costs:
 - (i) relate directly to a contracts;
 - (ii) relate to future performance under the contract; and
 - (iii) are expected to be recovered.
80. The contract cost proposals generated a mixed response, both in terms of the nature of the guidance and where that guidance should be located within IFRSs and US GAAP.

Contract acquisition costs

81. Many respondents disagreed with the boards' proposal to expense contract acquisition costs as incurred. Some of those respondents argued that contract acquisition costs should be recognised as an asset because of the following factors:
- (a) size of outflow—significant costs may be incurred to bid for and secure contracts in some industries (eg construction, outsourcing);

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- (b) relationship to inflows—costs that are incremental, necessary, directly related to a contract and recoverable through the contract should be recognised as an asset;
 - (c) responding to user needs—expensing those costs could confuse users because the entity may record a loss from recognising its bidding costs as an expense even though it has secured a profitable contract.
82. Other respondents were concerned by the appearance that the net effect of accounting for contract acquisition costs would be different under the proposed revenue standard compared with the proposals in the boards' projects on insurance, leases and financial instruments.

Fulfilment costs

83. Many respondents support the boards' proposal to provide specific guidance on the treatment of contract costs, and especially fulfilment costs. Many of those respondents requested that the boards clarify whether contract fulfilment costs would include:
- (a) additional costs incurred at the start of a manufacturing process to determine the optimal production process (ie learning curve costs);
 - (b) design and prototype costs that are incurred when bidding for the contract and that will be used by the entity to fulfil the contract (if awarded).
84. In addition, one respondent recommended that the boards include guidance to indicate that all fulfilment costs associated with a distinct good or service for which control passes on a continuous basis should be recognised in profit or loss in a manner that results in a consistent margin for that good or service.

Location of the cost guidance

85. Some respondents, particularly those from national standard setters and accounting professional bodies, commented that any cost guidance provided by the boards should be located in other standards rather than in a revenue standard.

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Disclosures

86. In the exposure draft, the boards proposed that, as a disclosure objective, an entity should disclose quantitative and qualitative information about its contracts and the significant judgements made in applying the proposals to those contracts. In order to meet that objective, the boards proposed that an entity should disclose the following information (as a minimum):
- (a) revenue disaggregated into categories, such as by type of good or service, by geography, by market or customer or by type of contract;
 - (b) a reconciliation (ie roll-forward) of contract balances;
 - (c) a description of the entity's performance obligation, including a maturity analysis of outstanding performance obligations associated with contracts with an original expected duration of more than one year; and
 - (d) liabilities recognised for onerous performance obligations, including a reconciliation of changes in that liability.

General comments on the disclosure objective and package of disclosures

87. Overall, there was general support for the disclosure objective, but most respondents—especially preparers and auditors—did not agree with the package of disclosures that were proposed to meet that objective.
88. Many comment letters included some general remarks on the overall disclosure package. The common themes from those remarks included:
- (a) The disclosures proposed are too prescriptive and some of the proposals would require information to be disclosed that could fail to meet the boards' disclosure objective. Thus, some respondents suggested that the disclosures proposed should not have mandatory application. Rather, they suggest that those disclosures should be presented as an indicative list of possible disclosures for management to consider when developing disclosures to meet the disclosure objective.

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- (b) The disclosures proposed would require excessive volumes of data to be disclosed. This is because some of disclosures proposed may provide useful information only to users of the financial statements of entities that operate in particular industries. For example, the backlog disclosure is generally regarded as providing useful information about entities with long duration contracts such as in the construction, engineering or outsourcing industries. However that information is less relevant to users of the financial statement of entities that typically only have short duration contracts, such as in the telecommunications industry. In addition, some of the disclosure proposed might duplicate other disclosure requirements, such as:
- (i) the ‘roll forward’ disclosures under consideration in the financial statement presentation project; and
 - (ii) the segment reporting disclosures required by IFRS 8 *Operating Segments* and ASC Topic 280 on segment reporting.
- (c) The totality of the proposed disclosure package goes beyond what is appropriate for general purpose financial statements. For example, some respondents considered that the backlog disclosure should be presented in management commentary because it is disclosing information that is forward looking.
- (d) Some of the disclosures proposed (eg description of the entity’s performance obligations and the disclosure of assumptions and uncertainties) are likely to yield ‘boilerplate’ disclosure. This is because the disclosure of qualitative information on these topics is likely to only be useful at the individual contract level. That level of detail would not be feasible for entities to disclose if, for instance, they have numerous contracts in numerous markets to provide various customers with a variety of goods or services.
- (e) Some of the disclosures proposed would be costly to prepare and to audit. In some cases, the information required to be disclosed is not

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captured in existing reporting systems (eg backlog information and the reconciliation of contract balances).

- (f) There is significant doubt regarding whether the disclosures proposed are cost-beneficial. Therefore, some respondents have suggested that the boards should field test the disclosures with preparers, auditors and users of financial statements.
- (g) Respondents encouraged the boards to give priority to developing a framework to guide the development of disclosures because they are concerned that the same issues about excessive and unnecessary disclosure are encountered across many projects.

89. In contrast, users generally expressed strong support for the general thrust of the disclosure package. For example:

We believe expanded disclosure is absolutely necessary under the proposed framework due to the significant amount of discretion involved in the amount and timing of revenue recognition.
(CL #965)

90. Some users shared the concerns that some of the proposed disclosure requirements might not be cost-beneficial or might be prone to encouraging 'boilerplate' disclosure.

Disclosure of remaining performance obligations

Backlog disclosure

91. As noted in paragraph 88(c) above, many preparers and auditors do not believe that the disclosure of backlog information should be included in the notes to the financial statements. However, if that information is presented in the notes to the financial statements, respondents—including users—generally agreed that the disclosure should be limited to those entities where backlog is a meaningful revenue indicator. That suggested limitation to the disclosure of backlog is broadly consistent with some respondents who stated that the disclosure should not be provided if that information is not already prepared and used to manage the business. Those respondents argue that the disclosure would fail a cost-

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benefit assessment if an entity is required to develop a system to capture that information solely for the purpose of disclosure.

Backlog disclosure

92. Most respondents seemed to agree with the boards' proposal to limit the scope of the backlog disclosure by only including those contracts that have an original duration of greater than one year. One respondent disagreed with that approach and instead suggested that the boards should extend the backlog disclosure to include all contracts. That respondent commented that it would provide more useful information to users and it should not add a cost to preparers because:

Most entities will collect details of all contracts...if only for the purposes of forecasting liquidity and confirming the going concern basis of their reporting and many entities already publish it as non-GAAP information.

For these preparers there will be an additional cost on limiting the disclosure to contracts with an original duration expected to exceed one year because they will need to be separately identified.
(CL #572)

93. Respondents also mentioned that the boards would need to clarify how backlog should be prepared to ensure that it is prepared consistently. For instance:
- (a) whether the measurement of the remaining performance obligations should be adjusted for time value of money;
 - (b) whether the disclosure should include performance obligations arising from framework contracts (ie a contract that establishes rates and/or working methods whereby the scope of work may be certain but the timing of that work is uncertain or the scope of the work may be uncertain) or from contracts with market testing or benchmarking provisions'; and
 - (c) whether the disclosure should include anticipated contract modifications and/or contract cancellations.

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Maturity analysis

94. In the exposure draft, the boards proposed that the backlog disclosure should also specify when those remaining performance obligations are expected to be satisfied. Many respondents were concerned by the consequences of disclosing such subjective and uncertain forward looking in the notes to the financial statements. For instance, as one respondent explains:

...significant judgment will be required to forecast the appropriate allocation of progress and resulting revenue to be recognized across all future periods in which those performance obligations are expected to be satisfied. The use of such judgments will introduce a level of uncertainty into audited financial statements that does not currently exist. While the information to factually determine the periods for which the goods/services will be transferred may be readily obtained for some contracts (such as retail or manufacturing contracts) most long-term contracts will not provide this factual information, and will thus require reliance on the entity's subjective judgments and projections. Separately, auditors will be required to audit the information as it is intended to be included in the footnotes, which could prove to be a significant and costly challenge given the inherent variability of the nature of the backlog within the [engineering and construction] industry and the forward-looking nature of the estimates. (CL #260)

95. Some respondents also disagreed with exposure draft prescribing that the maturity analysis disclosure should be presented in yearly intervals ranging less than one year to greater than 3 years. Some considered that broader intervals should be specified; otherwise it will have limited usefulness for entities with long-duration contracts. Other respondents suggest that management should use the intervals that are relevant for their contracts. They considered that specifying the interval was inconsistent with principle-based standards.

Disclose disaggregation of revenue

96. The views expressed on this proposed disclosure were mixed. Some respondents agreed that entities should disclose disaggregated information on revenue if they are currently required to disclose segment information. However, a common concern raised by respondents was whether, and to what extent, the proposed disclosure for the disaggregation of revenue either might

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duplicate the disclosures required by IFRS 8 and ASC Topic 280 or might yield information that users cannot reconcile to the disclosures required by those standards.

97. Some respondents were concerned that the disclosure might require an entity to disclose commercially sensitive information. A few respondents suggested that the boards should include an exemption from disclosing such information, similar to the exemption in paragraph 92 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. A few respondents also suggested that entities that are not required to provide segment disclosures should also be exempt from this requirement.

Transition, effective date and early adoption

98. There was mixed support for the boards' proposal for entities to apply the proposed requirements retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* or the guidance on accounting changes in ASC Topic 250.
99. Respondents generally agreed with the boards that applying the proposed requirements retrospectively would provide users of financial statements with useful trend information about revenue. However, nearly all respondents, especially preparers and auditors, did not think that the benefits of that trend information would be sufficient to justify retrospective application in the light of the substantial difficulties and costs that entities would face in applying the proposed requirements retrospectively to all their contracts with customers.
100. Many respondents commented that retrospective application would be impractical and difficult for entities with significant complex multiple element arrangements and/or complex long-term contracts. For example:

Factors such as the existence of long term contracts, contracts with multiple performance obligations, variable consideration, a significant number of contracts, or other items that require a significant degree of estimation will make retrospective application difficult and impractical. Retrospective application could require an

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entity to recreate information that it did not capture at the time the transaction was entered into, causing management to make subjective estimates about conditions that existed at that date and increasing the potential for the inappropriate use of hindsight. These estimates could reduce the relevance and reliability of the financial statements. (CL #190)

101. The transition approaches suggested by respondents include:

- (a) to defer the effective date or to provide an appropriate lead time to enable entities that can apply the standard retrospectively to have sufficient time to put in place the necessary systems to capture the information;
- (b) to permit a simplified approach to retrospective application for long-term contracts or to allow preparers to apply the impracticability exception in a wider range of situations;
- (c) to permit entities to choose whether to apply the proposed requirements retrospectively or prospectively (eg similar to the transition approach permitted by Accounting Standards Update No. 2009-13 *Multiple-Deliverable Revenue Arrangements*);
- (d) to disclose trend information or other information that explains the financial statement effect upon adopting the final revenue standard.

102. The exposure draft did not request comments on the effective date of the proposed requirements in the light of the boards' decision to publish a separate consultation document on effective dates. Nevertheless, many respondents commented on when a final revenue standard should become effective. Some of the respondents that commented did so either in the context of commenting on their preferred approach to transition (as outlined above) or on early adoption. Other comments on effective dates were made in relation to the time that would be necessary to develop and implement new accounting systems and to train staff. Smaller entities, including private entities, were among the respondents that expressed those comments.

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Application guidance

General comments

103. The views expressed in response to the boards' proposed application guidance can be broadly categorised as follows:
- (a) too much guidance is being proposed;
 - (b) too little guidance is being proposed; or
 - (c) the amount of guidance being proposed is about right.
104. Respondents that considered that the boards were proposing too much guidance typically were from jurisdictions that apply IFRSs. They argued that the level of guidance being proposed was inconsistent with the objective of developing principle-based standards. Moreover, they argue that issuing extensive application guidance to accompany the standard suggests that the boards have either not articulated the principles in the standard with sufficient clarity or that the boards possibly are using the wrong principles to design a standard on revenue recognition.
105. However, the majority of respondents were in favour of the boards providing application guidance. They explained that the guidance is needed because:
- (a) revenue is important;
 - (b) many existing interpretation issues relate to revenue recognition matters;
 - (c) it will help to promote more consistent application of the principles, especially given that existing revenue guidance (in US GAAP) is substantial and has also been relied on in interpreting IFRSs.
106. Almost all of those respondents indicated that the guidance proposed was not sufficient to make the proposals operational. Some suggested that the volume of guidance proposed was appropriate, but the content of that guidance needs improvement. A common request was that the boards should provide guidance that illustrates how an entity should apply the proposed requirements to fact

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patterns that are more realistic and require the entity to use judgement (eg in accounting for contract modifications).

107. Other respondents also requested the boards to provide guidance on additional topics because they did not think that the guidance provided was representative of the nature of their transactions or their industry. Some of the topics identified as requiring additional application guidance include accounting for:

- (a) a performance obligation that is conditional and in the control of the vendor, such as when-and-if upgrades;
- (b) activities that the entity would have performed absent the obligation in the contract, such as defending a patent underlying a licence;
- (c) transportation services, where it is unclear whether control of the transportation service transfers continuously or only upon delivery;
- (d) upfront fees, especially where the up-front fee relates to a service the entity expects to provide for an indefinite time period;
- (e) repurchase agreements or sales that include a residual value guarantee;
- (f) time value of money in multiple element arrangements and when there is continuous transfer of control (to the extent the principle of accounting for time value of money is retained in a standard);
- (g) breakage in a single element arrangement, such as gift cards;
- (h) circumstances where consideration is received from a party other than the direct customer (eg grocery coupons accepted by a retailer but redeemed by a manufacturer);
- (i) circumstances where performance obligations are provided to a party other than the direct customer (eg loyalty points provided to credit card customers);
- (j) arrangements that involve non-refundable up-front fees, payments for research services, milestone payments that are contingent on

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achievement of specific targets, and revenues based on future customer sales;

- (k) an example that illustrates the accounting for a contract with multiple performance obligations, some of which are in scope of financial instruments, insurance, or leasing standards; and
- (l) an example illustrating the disclosures required by the final standard.

Product warranties

108. In the exposure draft, the boards proposed that an entity should distinguish between the following types of product warranties:

- (a) a warranty that provides a customer with coverage for latent defects in the product (ie a quality assurance warranty). The boards' propose that these warranties do not give rise to a performance obligation but rather requires the entity to determine whether it has satisfied its performance obligation to transfer to the customer the product specified in the contract; and
- (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer (ie an insurance warranty). The boards' propose that these warranties give rise to a performance obligation in addition to the performance obligation to transfer the product specific in the contract.

109. Some respondents agreed that, in concept, a quality assurance warranty and an insurance warranty provide a customer with different types of protection against faults with a product. However, almost all respondents commented that it may be difficult and, in some cases, impracticable to determine when a fault has arisen in a product. For example,

- (a) in manufacturing industries, products often go through rigorous inspection processes prior to delivering a good to the customer and entities may not be aware of faults at the time of delivery; and

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- (b) in the software industry, it is not clear how an entity would determine whether a software bug fix is repairing a latent defect or a defect that occurred after the product was transferred to the customer.
110. Some respondents stated that with either type of warranty, the net effect of the accounting for the warranty would be the same—an amount of revenue is deferred. A few respondents supported a deferral of revenue for all warranties, but only in the context of accounting for all warranties as separate performance obligations. However, most respondents instead suggest that the boards should make a distinction between:
- (a) a standard warranty, which should be accounted for as a cost accrual in accordance with existing standards (ie IAS 37 and ASC Topic 450 on contingencies); and
 - (b) an extended warranty that is separately priced and sold separately, which should be accounted for as a separate performance obligation.
111. Most respondents consider an extended warranty that is separately priced and sold separately to be a separate performance obligation because it is clearly providing a separate service to the customer and it is a service that can be identified easily. In contrast, many respondents do not consider a standard warranty to be a separate performance obligation. They argue that the entity only has a performance obligation to transfer the product to the customer. Any subsequent repairs or replacements are additional costs or business expenses incurred by the entity.

Licensing and rights to use

112. A majority of respondents do not agree that an entity should distinguish between an exclusive and non-exclusive license and that such licenses should receive different accounting treatment for the following reasons:
- (a) the distinction will require judgment by management which may lead to less comparability of information due to the different accounting treatment for each type of license.

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- (b) whether or not the license is exclusive does not affect the nature of the asset received by the customer, therefore it is counterintuitive to have different patterns of revenue recognition.
 - (c) the accounting for exclusive licenses is inconsistent with the control principle and in effect introduces an additional and different criterion to determine when control has transferred.
113. Some respondents agree with the distinction between exclusive and non-exclusive licenses in the proposals, however are unclear how an entity would make this distinction and request that the proposals provide further guidance including:
- (a) additional indicators and further clarification of existing indicators to help entities determine if a license would be considered exclusive or non-exclusive.
 - (b) further clarification to determine if the guidance for licensing and rights to use is limited to intellectual property or also apply to licenses of intangible assets (ie customer lists not to compete); and
 - (c) further guidance on when an exclusive license is granted for substantially all of the property's economic life.
114. Some respondents suggested the following:
- (a) when determining the appropriate accounting treatment, the length of time the customer receives the benefit from the license and the vendor's additional performance obligations associated with the license should be considered.
 - (b) the distinction between exclusive and non-exclusive should be made from the entity's perspective if the entity is giving up any rights when the license is granted.
 - (c) the distinction should be determined based on the notion of temporary and non-temporary control.

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115. Many respondents are unclear as to how the proposals relate to the guidance included in the leases exposure draft and think that the guidance relating to intangibles should be dealt with in the leasing project since many respondents view the right to use of an asset or license as being similar to a lease.
116. Others think that the proposals in the exposure draft are inconsistent with the views in the leasing project because the exposure draft on leases excludes intangible assets from its scope.
117. Some respondents agree with the proposals and think that an exclusive license is similar to a lease and a non-exclusive license is similar to a sale of intellectual property and therefore should receive different accounting treatments.

Consequential amendments

118. The majority of respondents who commented on consequential amendments agreed with the proposed amendment that would require entities to account for a gain or loss on the sale of some nonfinancial assets in accordance with the recognition and measurement principles in the proposed revenue standard.
119. Some of those respondents requested the boards to provide additional guidance on that consequential amendment—for instance:
 - (a) which nonfinancial assets would be included in the scope of that amendment (ie sale of a business, segment disposal, discontinued operations); and
 - (b) which transactions would be presented as gains or losses and not as revenue.

In addition, a few respondents commented that the boards proposals on variable considerations may not be suitable for accounting for individual items of intangible assets and property, plant and equipment.

120. Respondents that disagreed with the proposed amendments typically requested for existing standards to be retained. For instance, respondents from rate

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regulated industries suggested that revenue from rate regulation should be excluded from the scope of the standard and that the existing guidance in US GAAP should be retained.

121. Some respondents commented that in order to fully evaluate the effect of the proposed changes, the boards should release the full text of the consequential amendments for public comment prior to the issuance of the final standard.

Other issues

Scope

122. Several respondents requested the boards to clarify the scope of the proposals, particularly in relation to:
 - (a) The meaning of ‘ordinary activities’—one respondent stated that the ordinary meaning of ‘ordinary activities’ is not helpful in clarifying scope because they consider that ordinary activities could be interpreted as encompassing all activities of the entity.
 - (b) Accounting for transactions between parties to a collaborative arrangement or a joint venture arrangement—some respondents in the pharmaceutical, biotechnology and extractive industries (ie industries in which these arrangements are commonly used by entities to share risks) suggested the boards clarify in the standard that transactions between parties to these arrangements in their capacity as partners would not be included within the scope of the standard because those transactions do not involve a customer-supplier relationship. In the exposure draft, comments to that effect are only made in the basis for conclusions.
 - (c) Accounting for exchanges of commodities between entities in the same line of business to facilitate sales to customers (ie third parties)—a respondent requested the boards to provide additional guidance on whether, and in what circumstances, an exchange of a commodity would be outside the scope of the standard if the exchange includes a

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monetary component to compensate for differences in the attributes of the commodity (eg in terms of quality or location).

Definition of revenue

123. A few respondents commented that the boards should adopt a common definition of revenue in their final standards.
124. Some other respondents queried whether revenue that did not arise from a contract with a customer (eg dividends, non-contractual royalties) would be able to be presented as revenue.

Revenue recognition from a not for profit entity perspective

125. The accounting standard setters in Australia and New Zealand have a policy of transaction neutrality, which has the consequence of requiring entities from the not-for-profit and public sectors to apply accounting standards that are based on IFRSs. Although the boards have developed the proposed model from a for-profit entity perspective, some respondents from Australia and New Zealand have requested the boards to give consideration to the following not-for-profit and public sector issues that would have an effect on the ability for entities from those sectors to recognise revenue on a consistent basis with the for-profit sector:

- (a) scope—whether the proposals could be expanded to include:
 - (i) non-exchange transactions, including grants; and
 - (ii) non-contract based revenues, such as taxes, fines, fees and grants, because contractual based revenues are often insignificant to not-for-profit entities;
- (b) control—whether the notion of control in these proposals could refer to:
 - (i) the entity losing control of an asset, rather than the customer gaining it; or

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- (ii) control being obtained by a beneficiary or agent of the customer;
 - (c) price interdependence—to further consider the application of the price interdependency principle for combining and segmenting contracts because prices may not always reflect the economics of a transaction in a not-for-profit situation;
 - (d) distinct goods or services—to further consider the ‘distinct profit margin’ criterion because some transactions may not be commercial and hence profit margins may not be a key consideration as to whether the goods and services are distinct;
 - (e) onerous performance obligations—to consider onerous social benefit contracts in the context of onerous performance obligations because often not-for-profit entities will intentionally provide goods or services at less than cost.
126. Requests for guidance on not-for-profit issues are also discussed in paragraphs 10-12 of the appendix to this paper.

**Staff
Paper**

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Project	Revenue recognition	
Topic	Comment letter summary – main issues	

Introduction and purpose

1. The exposure draft issued by the FASB included a question on whether any of the proposed guidance should be different for nonpublic entities (private companies and not-for-profit organizations). This appendix summarizes responses on that question.
2. In addition to the concerns highlighted in this appendix, nonpublic entities shared many of the concerns of public entities that are highlighted in the main comment letter summary (Memo 134A / agenda paper 3A).

Summary of responses to Question 18

Overall views

3. Generally, respondents think that the proposed recognition and measurement guidance should be the same for public and nonpublic entities because:
 - (a) Different requirements could lead to less comparability and consistency among public and private entities.
 - (b) Public and nonpublic entities often compete in the same markets and therefore should be required to comply with the same standards.

This paper has been prepared by the technical staff of the IFRS Foundation and the FASB for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

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The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

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- (c) It may be costly and cause confusion to have two sets of standards (one standard for public and another for nonpublic entities). Financial institutions, audit firms, users and entities would be required to maintain personnel with expertise in more than one set of standards.
- 4. However, most respondents think that disclosures and effective date should be different for nonpublic entities.
- 5. Some respondents asked the Boards to clarify whether the proposed guidance would affect current accounting for contributions or grants.
- 6. A few respondents think that it should be the responsibility of other committees, such as the Private Company Financial Reporting Committee (PCFRC), to decide whether there should be different requirements for nonpublic entities, rather than the FASB.

Application to the construction industry

- 7. A majority of respondents who commented on question 18 were either small, privately held construction entities or the sureties who provide credit to these construction entities.
- 8. Many of these respondents do not agree with many aspects of the proposals (as described in Memo 134A / agenda paper 3A), and think that the information provided under ASC Subtopic 605-35 on construction-type and production-type contracts (formerly SOP 81-1) is useful and meets the needs of users in the construction industry. Therefore, they are not convinced that the proposals represent an improvement to current guidance. Accordingly, these respondents recommend that the Boards should either:
 - (a) Provide a scope exception for nonpublic entities; or
 - (b) Retain some of the main principles in SOP 81-1 or provide a scope exception for construction contracts.
- 9. Many sureties in the construction industry think that the proposals would not provide useful information about their clients' construction contracts and stated

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that if the proposals become effective for nonpublic entities, they would continue to require supplemental information from their clients, similar to what they receive today in accordance with SOP 81-1. As a consequence they noted that nonpublic entities may be required to keep two sets of accounting records: one to comply with GAAP and another to comply with the needs of users (such as sureties).

Not-for-profit organizations

10. Of the respondents who commented on not-for-profit organizations, most noted that the focus, needs and user base of not-for-profit organizations is different from for-profit entities. Therefore, they think the Boards should consider separate guidance for these entities.
11. Some respondents think that the proposals should apply only to specified revenue generating activities, noting that the proposals would not be appropriate for grants or contributions.

With respect to not-for-profit organizations and based on our general business experience, we believe the proposed ASU should apply to only certain elements of their revenue streams, namely those revenues that relate to the delivery of goods and services for a fee where there are for-profit enterprises offering similar services. Examples might include patient billings for hospitals, tuition and fees for students in higher education institutions, customer revenues for municipal owned public utilities and the like. (CL# 243)

12. Some respondents do not think it would always be appropriate to recognize a liability for an onerous performance obligation in situations in which goods or services are provided at a price that is less than cost. For example, a not-for-profit railway may recover only a small percentage of costs through customers and the remaining may be collected from the government.

Research contracts

13. A few respondents, mainly in the healthcare industry, questioned how the proposals would apply to research projects. Specifically they had concerns

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about identifying performance obligations and determining when control is transferred. For example, they asked whether the performance obligation is to provide research services over time or to provide a research report at the completion of the project.

Disclosure

14. Many respondents think that nonpublic entities do not need to provide the same level of disclosure as public entities. They think that the proposed disclosure requirements would:
 - (a) Not provide useful information to users of nonpublic entities. Most users of nonpublic entity financial statements have more direct access to management, can obtain information when needed, and already receive supplemental financial information in addition to what is required by existing guidance based on their individual needs.
 - (b) Provide information that is too detailed and may not be useful to users of financial statements of nonpublic entities.
 - (c) Be costly and time consuming with benefits that would not outweigh the costs, particularly if the disclosures are required on a quarterly basis.
15. Many nonpublic entities stated that they do not keep records that will enable them to present disaggregated revenue. In addition, they noted that the proposed disaggregation requirement is similar to segment reporting, which is not required for nonpublic and not-for-profit entities.

Effective date

16. Most respondents think that the effective date for nonpublic entities should be set one to two years after the effective date for all other entities to allow such

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entities additional time to evaluate the effect of the standard and make the necessary changes to implement the standard.

Costs and benefits

17. Many respondents think that implementing the proposed requirements may be extremely costly and time consuming and may not provide useful information for nonpublic entities. Additionally, they indicated that the benefits of the proposals may not outweigh the costs.
18. Specifically many respondents raised concerns that implementation of the proposals may lead to:
 - (a) Increased costs from having to hire more personnel to implement the proposals and from the additional time required to educate new and existing staff. Many nonpublic entities are currently struggling to remain profitable and therefore do not welcome additional accounting costs.
 - (b) Higher professional fees including audit fees or fees from external experts. Many nonpublic entities would be required to rely heavily on their CPA firms to provide assistance in implementing the proposals.
 - (c) The need to reconcile GAAP financial information to the information required by sureties or other users.
 - (d) Increased cost to users that provide credit to nonpublic entities.

Information technology

19. Some respondents noted that nonpublic entities may need new or improved systems and controls around those systems in order to comply with the proposals. They noted that many existing systems would not be able to perform certain tasks required by the proposals (eg combining and segmenting contracts, recording multiple performance obligations, presenting contract assets and liabilities separate from accounts receivable, and reducing the transaction price

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for collectability). In addition, most current software for construction contracts has been designed specifically to comply with existing guidance.

20. Many nonpublic entities currently manage their contracts through the use of manual accounting systems and think they would need to purchase software and other technology to implement the proposals.

Transition

21. Many respondents do not think that nonpublic entities should apply the proposed requirements retrospectively because most users of these entities generally have direct access to management and can request additional information if needed. Therefore, they think that the benefits of the financial information resulting from retrospective adoption may not outweigh the costs of producing it.

Tax implications

22. Some respondents are concerned about the potential tax implications on nonpublic entities arising from the proposed standard and the potential increase in costs.
 - (a) Entities would be required to keep a separate set of books to comply with tax reporting (currently, many tax accounting requirements are similar to the requirements of SOP 81-1).
 - (b) Preparation of income tax and deferred tax provisions could be more complex.