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Project	<b>Revenue Recognition</b>
Topic	<b>Comment Letter Summary</b>

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### Purpose of this paper

1. This paper summarizes responses to the Boards' Discussion Paper, *Preliminary Views on Revenue Recognition in Contracts with Customers* ("DP"). The DP presents a contract-based revenue recognition model and seeks respondents' views on the model and its potential for development into a single revenue recognition standard for both U.S. GAAP and IFRSs.
2. The purpose of this paper is to communicate the main themes of respondents' comment letters based on the staff's preliminary analysis. The staff will provide more detail on the responses as individual topics are discussed at future meetings. This paper is intended as an input to the process of setting priorities for work over the next few months. It does not provide enough information to support decisions on technical issues.

### Overview of the comment letters

3. The six-month comment period on the DP ended on June 19, 2009. As of July 13, 2009, the Boards have received 211 comment letters which are summarized below by type of respondent and geographic region.

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This paper has been prepared by the technical staff of the FAF and the IASCF for discussion at a meeting of World Standard Setters.

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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<b>Respondent type</b>	<b>Number of respondents</b>	<b>Percentage of respondents</b>
Preparer	79	37%
Professional institutions	40	19%
Industry-specific trade association	32	15%
Standard setter	18	9%
Individual	14	7%
Accounting firm	9	4%
Investor/analyst/user	6	3%
Non-industry specific focus groups	6	3%
Academic	3	1%
Regulator	3	1%
Other (e.g. NFP, public sector)	1	<1%
<b>Total</b>	<b>211</b>	<b>100%</b>

<b>Geographic region</b>	<b>Number of respondents</b>	<b>Percentage of respondents</b>
Europe	76	36%
North America	75	36%
Australia/New Zealand	19	9%
Multinational	13	6%
Asia Pacific excluding Australia/New Zealand	12	6%
Africa	5	2%
Middle East / India	4	2%
Central/South America	1	0%
N/A	6	3%
<b>Total</b>	<b>211</b>	<b>100%</b>

4. For this paper, respondents' comments are summarized as follows:

- (a) Overall views (paragraphs 5-18)
  - (i) Project objective
  - (ii) Proposed model
  - (iii) Alternative recognition model
  - (iv) Field testing and timetable
- (b) Scope (paragraphs 19-35)
  - (i) Definition of revenue
  - (ii) Definition of a contract
  - (iii) Definition of a customer
- (c) Recognition (paragraphs 36-68)
  - (i) Definition of a performance obligation

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- (ii) Identification of performance obligations
- (iii) Satisfaction of performance obligations
- (d) Measurement (paragraphs 69-83)
  - (i) Overall views on measurement approach
  - (ii) Initial measurement
  - (iii) Allocation approach and use of estimates
  - (iv) Subsequent measurement
- (e) Costs (paragraphs 84-89)
  - (i) Contract origination costs
- (f) Other issues (paragraphs 90-94)
  - (i) Collectibility
  - (ii) Uncertain consideration
  - (iii) Gross versus net presentation of rights and obligations

## Overall views

### *Project objective*

5. Nearly all respondents support the Boards' objective to develop a single revenue recognition model for U.S. GAAP and IFRSs that will improve existing standards.

We support the Boards' intention to develop a single principles-based standard for revenue recognition that can be applied to all industries. (CL #123)

6. However, many respondents question the feasibility of the objective. Specifically:
  - (a) many respondents question whether a single model can provide useful information across various industries, given the wide variety of contracts. They urge the Boards to not pursue consistency of accounting across industries for the sake of it: "the goal of consistency

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should be secondary to the goal of providing decision-useful financial reporting.” (CL #211)

- (b) some respondents who currently apply IAS 11, *Construction Contracts* and IAS 18, *Revenue* note that although those standards might be inconsistent, they provide useful information about the different types of contracts for which they are intended. Similarly, some respondents who apply U.S. GAAP note that industry-specific standards were created to clarify how to recognize revenue for particular industries. They think that the need for different standards indicates that a single model might not suit all transactions. In addition they think the Boards have already indicated a need for more than one model by highlighting in the DP that some contracts might be scoped out (e.g. financial instruments, leases and insurance contracts).
- (c) a few respondents note that a single model could lead to inconsistent interpretation and application across industries which could reduce comparability of financial reporting.

[Some] are concerned whether in practice a single set of principles-based guidance applied in politically, culturally and economically diverse settings would in and of itself result in more consistency and comparability. (CL #184)

- 7. Some respondents think a new revenue recognition standard is not needed:
  - (a) The Boards should focus on other projects that either may be more important because of the global financial crisis or are precedential such as the Conceptual Framework project.
  - (b) Requiring all entities to apply a single revenue recognition model would not provide information that is more decision useful than that provided by existing standards. Some argue that the proposed model would not provide benefits to financial reporting that outweigh the costs of implementing a new standard.
  - (c) The Boards should focus on fixing problems in existing standards, such as accounting for multiple-element arrangements, rather than develop a new standard, which carries the risk of unintended consequences. In

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particular, many respondents argue that IAS 11 and SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* work well in practice (and have for many years). Therefore, the Boards should retain a similar model.

### ***Proposed model***

8. Most respondents generally support the recognition and measurement principles proposed in the DP. However, nearly all respondents comment that those high-level principles, to be applied consistently, will require a well-developed supporting framework. In particular, the principles need implementation guidance and examples on key issues such as the identification, measurement and satisfaction of performance obligations.

We are also cautiously supportive of the boards' focus on a single principle to drive the recognition of revenue insofar as it focuses on the extent to which a promised good or service has become the asset of the customer, though we have some concerns over how this concept may be developed or expressed at the next stage of the project. (CL #9)

9. Some respondents note that although many of the existing revenue recognition standards have been developed piecemeal, some of those standards have proved to work well in practice. Therefore they "urge the boards to consider the best of that existing material when moving to the next stage of the project, with the aim of preserving the best aspects of existing GAAPs to the extent that those aspects are compatible with the DP's proposals." (CL #110)
10. Many respondents question how the model would apply to particular industries (e.g. financial services, real estate, and software) and to transactions involving intangibles assets (e.g. rights-to-use, royalties, and franchises). For instance, some struggle with determining when, if ever, control of intellectual property (including software) is transferred to the customer.
11. Many respondents state that the proposed model is too incomplete for them to fully evaluate it and conclude whether it would provide decision-useful information about most contracts with customers. They comment that some of the topics not covered in the DP (e.g. measurement of rights) are critical to

understanding a revenue recognition model. Therefore, some recommend that the Boards first complete the model and then issue another discussion paper before developing an exposure draft, so that constituents could properly evaluate the proposed model.

12. Apart from those industries noted above that were unsure about how the model would be applied, three industries raised particular concerns about the proposed model:

- (a) long-term construction
- (b) telecommunications
- (c) insurance.

*Long-term construction*

13. The most frequently-expressed concern relates to how the proposed model would apply to long-term construction and other service contracts, and whether it would provide decision-useful information. Many respondents interpret the DP as precluding percentage-of-completion accounting and resulting in revenue recognition only upon completion of those contracts. Many respondents think that pattern of revenue recognition would not provide decision-useful information because it would not reflect the economic activity of the entity under the contract. Because that information is useful, entities would in any case provide it to users through additional disclosures.

*Telecommunications*

14. All respondents from the telecommunications industry have concerns about the costs of implementing the proposed model. They highlight their large customer base and note that the proposed model could be applied at the individual contract level only after significant modifications to existing systems and processes. In their view, the costs of those modifications would not be justified.

“Having to calculate (even if netted) an asset and a liability on a gross basis for each of our contracts would inevitably mean that we were to implement completely new IT systems replacing current systems. This IT system would be necessary since the (forced)

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allocation of the customer consideration to the different performance obligations cannot be handled by current systems.” (CL #24)

### *Insurance*

15. Almost all insurers disagree with the measurement approach proposed in the DP. In particular they think that revenue should be recognized at contract inception to cover contract acquisition costs. Moreover, they think that performance obligations should be remeasured throughout the contract rather than only when deemed onerous. Some insurers state that they would prefer that the Boards develop a measurement approach that could also apply to insurance contracts. They note that the Boards could then develop appropriate simplifications to deal with many other types of contracts.

### ***Alternative recognition model***

16. A few respondents, mainly Europeans, do not support the Boards’ proposed recognition model and support an activities-based revenue recognition model. Those respondents think that under the proposed model, revenue would not properly reflect the activity that has been performed under a contract. They think that the performance of an activity, or the value created by an entity, should be used as the basis for recognizing revenue.

...we do not share the conclusions drawn in the Discussion Paper (DP) that this single revenue recognition approach should be that revenue is recognized upon fulfilment of contractual performance obligations. Instead, we prefer as the single revenue recognition approach the so called continuous approach under which revenue is recognised continuously over the course of the contract as the contract progresses (see EFRAG PAAinE Discussion Paper - *Revenue Recognition – A European Contribution*, pages 49 – 64). Compared to the approach proposed in the DP, the continuous approach provides more decision-useful information to users of financial statements about the activity and performance of the reporting entity. (CL #178)

17. Many of those respondents comment that a fundamental weakness of the DP is that it does not fully discuss what revenue should depict in the financial statements, nor how it relates to the broader question of reporting financial performance.

***Field testing and timetable***

18. Many respondents note the need to test the proposed model on a wide-variety of industries. Some question whether the new standard could be finalized by 2011, given the number of issues that need to be resolved, and are concerned the Boards may rush their decisions in order to meet a deadline.

We recommend the boards consider the practical implications of the proposed new model and undertake appropriate impact assessments and field tests to ensure that it can be universally applied and that the benefits of adopting it would outweigh the costs of changing over from existing revenue recognition approaches. (CL #17)

**Scope**

19. The majority of respondents agree that the proposed model should apply to contracts with customers.
20. In the DP, the Boards did not propose excluding any particular contracts with customers from the scope of the new standard. However, the Boards expressed concerns about the applicability of the proposed model to financial instruments, insurance contracts, and leasing contracts.
21. Most respondents think that financial instruments, insurance contracts, and leases should be scoped out of the new standard.

We do not believe the DP provides enough background to understand how its principles would be applied to financial services contracts, including financial instruments, insurance contracts and leases. While these are not explicitly scoped out of the proposal, we agree with the Board's concern that the proposals may not provide decision-useful information about all such contracts. (CL #116)

22. However, respondents request that the Boards keep current projects, in particular the projects on insurance and leases, consistent with the revenue recognition model or explain the reasons for any differences.
23. Although most agree that financial instruments should be scoped out, the financial services industry is not clear whether, and if so which, fees associated with financial instrument contracts would be in the scope of the new standard.



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24. A few indicate that the proposed model would not be appropriate for contracts for the sale of items that are measured at fair value through profit and loss (e.g. investment property, agricultural and biological products, and financial instruments) because the gains and losses would be recognized prior to performance obligations being satisfied.
25. Some question how the model would apply to the other types of revenues addressed in IAS 18 such as dividends, interest and royalties (which can be statutory and not contractual).
26. As noted above, the construction industry is unsure how the model would apply to them. If the proposed model precludes continuous revenue recognition, they would prefer to be scoped out of the new standard.

### **Definition of revenue**

27. Some respondents request the Boards provide a clear definition of revenue. They note that it is not clear from the comments in the DP with respect to agricultural, biological and extractive products, whether revenue from contracts with customers would be the only source of income that would be described as revenue. On that point there were mixed views. Some argued that changes in the value of assets outside a contract do not give rise to revenues, others specifically noted that revenue is not solely linked to contracts:

However, the AASB does not consider that revenue should arise only from contracts with customers. It notes that revenue is an important metric in valuation models used by various users of financial statements, and considers that precluding the following types of income from being reported as revenue (because they are outside contracts with customers) would reduce the relevance of the financial information reported:

- (a) Returns to investors in equity instruments (for example, revaluation increments); and
- (b) Growth of biological assets, particularly those that do not reach saleable condition for a long period of time.

Therefore, the AASB recommends that the Boards develop a robust concept of revenue that can be applied to all entities and activities and does not exclude the types of income identified above. (CL #89)

28. In addition, some respondents recommend that the decisions reached in the Conceptual Framework project should be consistent with the Revenue Recognition project specifically relating to the definition of revenue.

As the Boards develop the exposure draft (ED), we recommend that the link between the Conceptual Framework and the decisions made in the revenue recognition project be made clearer. For example, in paragraph 6.16 of the DP, the Boards state that they are considering whether entities currently accounting for their inventory under IAS 41, *Agriculture* should record increases in the value of inventory as another component of comprehensive income instead of revenue. The basis for this decision is not explained by reference to the Conceptual Framework or as a differentiation between revenue and other gains. We recommend that such decisions be explained by reference to the Conceptual Framework. (CL #179)

***Definition of a contract***

29. Many respondents note that the proposed definition of a contract in the DP (“an agreement between two or more parties that creates enforceable obligations”) although consistent with other areas of GAAP such as IAS 32, *Financial Instruments*, is worded differently. Many think the Boards should either use the IAS 32 definition or modify IAS 32 to conform to the definition in the DP.
30. A few respondents request that the Boards clarify or further expand on the term “enforceable”. Respondents are unsure what it means for well-established practices of providing additional goods and services. Some note that an entity could have a constructive obligation to provide goods and services that may not be legally enforceable. Others note that customer loyalty points and “when and if available” software upgrades that are accounted for as performance obligations in existing standards may not be legally enforceable. Some note, however, that although the entity might not be obliged to develop the upgrade, it is nonetheless contractually obliged to provide it to the customer if it is developed.
31. Some read the definition of a contract and the related material as similar to the existing requirement of “persuasive evidence of an arrangement” in SAB 104, *Revenue recognition* but are unsure whether the Boards’ intent is to establish a different threshold for the existence of a revenue transaction.

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32. Some note that the focus on contracts could lead to different accounting for similar economic arrangements depending on the legal jurisdiction.

We question if the phrase ‘enforceable obligations’ puts more onus on the legal form of the customer relationship over the commercial substance. (CL #116)

33. Others stressed the importance of commercial substance:

The Boards’ emphasis on the contract makes it important to differentiate between arrangements and contract terms that are substantive and those that lack commercial substance. (CL #68)

34. Some respondents think that the definition of a contract should include reference to both rights and obligations. Others think it should include the notions of “offer” and “acceptance”.

### ***Definition of a customer***

35. Some respondents request that the Boards enhance or modify the proposed definition of a customer (“a party that has contracted with an entity to obtain an asset (such as a good or service) that represents an output of the entity’s ordinary activities”). In particular, respondents question what the Boards mean by “ordinary activities”.

## **Recognition**

### ***Definition of a performance obligation***

36. Most respondents support the proposed definition of a performance obligation (“a promise in a contract with a customer to transfer an asset (such as a good or a service) to that customer”). However, many think that the definition is vague and could not be applied consistently in practice.

The definition is broadly fine as a starting point, but the DP contains insufficient guidance for users to be able to apply it consistently in practice. (CL #110)

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37. Many respondents comment that the definition of a performance obligation implies that an entity could promise to transfer an asset other than a good or a service. However, the DP does not explain what that other asset might be.
38. Some respondents think it is awkward to describe a service as an asset. They suggest deleting “asset” in the definition of a performance obligation and expressing it only in terms of goods and services.
39. Some note that the phrase “that customer” in the definition of performance obligation may not apply to all scenarios because an entity may transfer the good or service to another party.

### ***Identification of performance obligations***

40. Most respondents support the proposal that an entity should identify separate performance obligations based on when the goods and services are transferred to the customer.
41. However, some respondents think the proposal is not sufficiently clear and robust to improve existing standards. For instance, some note the potential uncertainty of when goods and services are transferred to the customer. Moreover, the separation of performance obligations could be required for presentation or disclosure.
42. Therefore, many respondents recommend the Boards provide additional criteria for the identification of performance obligations.

AIA further believes that the proposed definition of a performance obligation and the proposals on the separation of performance obligations will need to be supported by further guidance if entities are to be able to identify the deliverables in (or components of) a contract and apply the definition of the principle in a consistent way.  
(CL #192)

43. Some respondents suggest that a performance obligation should be accounted for separately only if it has stand-alone value to the customer, e.g. if the additional deliverable is either an optional extra or could be sourced from a different supplier. Many recommend that the Boards retain the criteria for

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separating a deliverable based on stand-alone value to a customer in EITF 00-21, *Revenue Arrangements with Multiple Deliverables*.

44. Others think that if a good or a service is incidental to the primary good or service, it should not be accounted for as a separate performance obligation. Respondents comment that entities could apply the model more easily if the standard would allow them to dismiss perfunctory or inconsequential performance obligations, similar to the accounting prescribed in SAB 104.

However it is vital that the accounting standard makes it clear that separate identification does not mean separate accounting for micro parts of the contract. The risk is that the requirements become impractical to apply where contracts are analyzed into an infinite number of immaterial components. (CL #163)

45. For many respondents, the main concern is that the proposed principle is not appropriate when there is continuous transfer of goods and services in a contract, as in long-term services contracts. Respondents think it would be difficult to determine how obligations in such contracts would be identified consistently because there are many ways the contract could be divided into separate performance obligations.
46. Many also question the applicability and decision usefulness of identifying many performance obligations in a long-term construction contract. Some respondents suggest that long-term construction contracts be treated as a single performance obligation satisfied over the life of the contract or suggest that units of account be identified based on the segmentation criteria in IAS 11 and SOP 81-1.

...construction contracts typically do not separately specify all the activities that are required to be performed by the contractor in order to fulfil its obligations. The sheer size and complexity of long-term construction contracts are such that the concept of separate 'performance obligations' may be of little relevance to users and also subject to interpretation. (CL #10)

47. Respondents provide specific comments on the following types of performance obligations: (a) warranties (b) goods sold with a right of return (c) promotional promises (sales incentives) and (d) some other types of performance obligations.

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### *Warranties*

48. Nearly all who comment on warranties think that a standard warranty should be accounted for differently from an extended warranty. They think there is an economic difference between a standard warranty and an extended warranty that often is priced and sold separately.

Standard warranties are unlike extended warranties that are generally separately priced, have standalone value and provide the customer with an asset beyond the standard warranty attached to the original product delivery. (CL #36)

49. Furthermore, many respondents think that a standard warranty should not be considered a separate performance obligation because it simply warrants that the entity has provided the functioning good or service it promised to provide. In other words, they think a standard warranty relates to whether a performance obligation for the related good was satisfied. They recommend such warranties be accounted for in accordance with SFAS 5, *Accounting for Contingencies* and IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.
50. The majority of respondents think that extended warranties are a separate performance obligation because they provide an asset in addition to a functioning product.

### *Goods sold with a right of return*

51. Most respondents think that the existing accounting for sales returns should be retained.

We believe the current accounting for sales returns under FASB Statement No. 48 *Revenue Recognition When Right of Return Exists*, is consistent with the economics of transactions, provides decision-useful information to users and is generally straightforward, well understood and applied. (CL #148)

52. Respondents provide varied responses on whether a right of return is a performance obligation. Some respondents think that a right of return is a promise expressed in a contract and is a performance obligation. Others think it should be accounted for as a failed sale. Still others think that the performance obligation and failed sale view are not mutually exclusive and can be combined.

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### *Promotional promises (sales incentives)*

53. Respondents have mixed views on how to account for sales incentives. Some respondents are unsure how to distinguish marketing expenses from a sales incentive that would qualify as a performance obligation. Others request clarification on how to identify performance obligations for consideration paid to a customer and suggest retaining existing guidance in EITF 01-09, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)*.
54. In response to the specific examples in the DP, a majority of respondents think that promotional promises give rise to performance obligations if they are provided in a contract with a customer. Many suggest using the significant and incremental notion from TPA 5100.50 *Definition of more-than-insignificant discount and software revenue recognition* to determine how to account for those options in the proposed model.
55. However, some respondents think that a sales incentive to provide a free good or service should be accounted for differently from a discount on a future good or service. Some respondents think that free future goods or services should be accounted for as performance obligations, while discounts on future goods and services should not be accounted for as performance obligations. For example, in response to the examples in the DP one respondent notes:

...the promise to transfer music to a customer at a discount is not a performance obligation because the customer must pay additional consideration to obtain the online music. The promised discount relates to a future contract and cannot be a performance obligation in the existing contract. The gift card is a separate performance obligation. The customer is not required to pay additional consideration to obtain the online music. The customer receives an unconditional and enforceable right to download a certain amount of music. That right could be sold separately. (CL #15)

### *Other performance obligations*

56. Respondents highlight various contract-related obligations and question whether they would be performance obligations resulting in revenue recognition when satisfied. Examples include product liabilities, product recalls, non-compete agreements, and obligations to defend rights to intellectual property.

**Satisfaction of performance obligations**

*Overall views on control*

57. Most respondents agree that an entity satisfies performance obligations when it transfers assets to a customer. Most also agree that control is the proper tool for determining when an asset is transferred.

We believe that a focus on control, in combination with the appropriate identification of performance obligations, will result in more consistent decisions about when assets are transferred and when revenue is recognised. (CL #68)

58. However, nearly all respondents state that the DP lacks a clear definition of control. Therefore they request further clarification of the meaning of control, especially in contracts for services or intangible products, and highlight the need for application guidance on “how an entity will determine when control of a good or service has transferred to the customer.” (CL #123)

*Application of control*

59. Control is the issue of greatest concern among respondents. Respondents often assume that control is transferred either based on the passing of legal title or when the customer gains physical possession of a good.

...many of the examples presented in the DP suggest that control does not transfer until title transfers. Accordingly, the DP gives the impression that the transfer of control is ultimately determined by the legal transfer of title. It is unclear if the Boards intended such a result. (CL #123)

60. In particular, many respondents express concern with construction contracts because legal title to, or physical possession of, the *completed* asset might not be transferred until the end of the contract. Hence, revenue would not be recognised until that point. They think that is inappropriate because they consider many of their contracts to be contracts for construction services that are provided over the contract term.
61. Some think the proposed model allows continuous revenue recognition in some construction contracts, but think that the notion of a continuous-delivery contract needs to be expressed more clearly. They note that under a transfer



model, some long-term construction contracts may be contracts for completed goods and others may be contracts for services. They think the Boards need to do further work on making that distinction before they can consider whether such significantly different accounting would be appropriate for such contacts.

62. In addition, some respondents note concerns about the implications of a legalistic interpretation of control for an international standard and that it may result in companies structuring transactions to receive specific accounting treatment.

Revenue recognition becomes inconsistent if the revenue recognition for a simultaneous delivery of two identical products into two different jurisdictions is made at two different occasions only because the local rules for transfer of ownership in these two jurisdictions differ. How can the application of an IFRS be made dependent on inconsistent local legal rules? For example, shall revenue be recognized when a truck has been formally registered, which in many countries may be the point of time when legal transfer occurs instead of, as today, at the delivery to the customer? Also, how do internationally accepted delivery terms (Incoterms) interact with laws and rules in different countries? Often the combination of local rules can be very complex, for example the impact on these from income tax and VAT legislations. (CL #43)

63. Some respondents question how the use of control in the revenue recognition project relates to the Derecognition, Consolidation and Conceptual Framework projects.

The current work on the conceptual framework project is removing the concept of control from the asset definition – as the Boards believe that it is misunderstood – and the new definition will focus on rights or privileged access to economic resources. (CL #123)

*Suggested application guidance for control*

64. Many respondents recommend the Boards provide indicators for when control of an asset has transferred.

Additional guidance is required as to what are the indicators of control. We believe that transfer of legal ownership is (ordinarily) an indicator that control has passed, however it should not preclude earlier recognition of revenue if other strong indicators show that control has passed. (CL #50)

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65. Some respondents provide useful examples of indicators of when control has transferred such as:
- (a) The customer has the ability to make substantial changes or modifications to the underlying asset during construction of the asset.
  - (b) The underlying asset is highly customized to the customer.
  - (c) The customer has the ability to pledge the asset or restrict access to it.
  - (d) The customer has legal title to the asset.
  - (e) The customer has physical possession of the asset.
  - (f) The customer bears risk of loss to the asset.
  - (g) The customer has the right to direct use or consume the asset as services are performed.
  - (h) The customer is required to make non-refundable payments or continuous payments during work-in-process.
66. Instead of indicators of when control is transferred, some respondents think it would be more practical to focus on drawing a distinction between a good and a service. The service, by definition, would be a continuously satisfied performance obligation. Furthermore, they think the key to distinguishing between a good and a construction service contract is that the asset is entirely specific to a particular customer so that the seller is required to execute the customer's design decisions.

### *Control versus risks and rewards*

67. Some respondents support retaining the notion of risks and rewards which they argue would allow an entity to account for the substance of the transaction in comparison to control which they view as accounting for the form of the transaction. They note that the notion of control might not reflect the substance of transactions in which entities sell and repurchase products in a manufacturing process. Some also think the notion of control is subject to traditional abuses in revenue recognition (e.g. "roundtripping" and "channel stuffing").

68. At the very least, many respondents think risks and rewards should be used an indicator of control.

The ASB considers that the DP has not demonstrated the superiority of ‘control’ over ‘risk and rewards’ ... In its response to the IASB’s ED 10 ‘Consolidated Financial Statements’ ... the ASB stated that it believed that the IASB should not remove the notion of ‘risks and rewards’ from the definition of ‘control’. The ASB considers that the ‘risk and rewards’ model should still play a key role in providing answers to the more difficult cases for revenue recognition, where it can be helpful in assessing and determining control. (CL # 97)

## Measurement

### *Overall views on measurement approach*

69. Most respondents support the measurement approach (the allocated transaction price approach) proposed in the DP. They agree that (a) performance obligations should initially be measured at the original transaction price and (b) those initial measurements should be updated (i.e. remeasured) only if a performance obligation is deemed onerous. Many respondents also note agreement with the Boards’ rejection of the current exit price approach because they think it would have been difficult to apply, would lead to errors and inconsistencies, and would produce information that is not decision-useful for users.

The GASB agrees that performance obligations should be measured initially at the transaction price because we share the opinion of the IASB/FASB that a current exit price would rarely be observable for the remaining performance obligations in a contract with a customer. Furthermore, we seriously doubt the relevance of a current exit price approach because the entity’s reporting should reflect its own performance. (CL #178)

### *Initial measurement*

70. Most respondents support the proposal to allocate the transaction price to performance obligations and that an entity should recognize revenue only from satisfying a performance obligation. Many respondents agree that revenue should not be recognized at contract inception because a performance obligation

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has not yet been satisfied. Other than insurers, only a few respondents think that entering into a contract can be a revenue-generating activity.

71. Almost all insurers think that revenue should be recognized at contract inception because part of the premium provides recovery of acquisition costs recognized as an expense at inception.

Initial acquisition costs are significant to the economics of insurance and investment contracts. The valuation of these contracts, at inception and subsequently, should exclude premium income required to offset initial acquisition costs. Accordingly, such amounts should be recognised as revenue on contract inception.  
(CL #112)

### ***Allocation approach and use of estimates***

72. Most respondents support the proposal to allocate the transaction price to performance obligations on the basis of the stand-alone selling prices of the goods and services underlying the performance obligations in a contract.
73. However, some think the amount allocated to a particular performance obligation should be constrained to amounts that are not contingent on delivery of future goods and services. For example, the telecommunications sector did not agree with allocating some of the consideration to a “free” handset in a service contract.

From a conceptual point of view, the forced allocation of the consideration to be received from the customer to the different performance obligations under a contract with a customer would in our business lead to a recognition of revenue that is contingent on the provision of other performance obligations at a later point in time. (CL #24)

74. Respondents also support the proposal to allow management to estimate stand-alone selling prices in situations in which an observable price is not available. For example, a study conducted by [revenuecongestion.com](http://revenuecongestion.com) found that:

74% of respondents agree or strongly agree that management should be allowed to apply estimates for goods/services that are not sold separately. (CL #12)

75. Although a majority of respondents support estimating the stand-alone selling price of a good or service, many have concerns and request further guidance on

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appropriate methods of estimating selling prices to ensure consistency. For example, some suggest methods of estimating stand-alone selling prices based on estimated costs, estimated costs plus margin, or a form of a residual method. Some also have concerns over the reliability of estimates, specifically when prices are not observable and are difficult to estimate.

When estimated standalone selling prices cannot be reliably determined, we recommend that the boards consider permitting appropriate alternative bases (such as the expected costs of the promised goods or services) to be used that would enable entities to establish verifiable support for their allocation of the transaction price to the separate performance obligations. (CL #17)

76. Some respondents prefer a hierarchy of estimation methods to make allocations as consistent as possible. For example, some indicate a preference for a hierarchy similar to that proposed in EITF Issue No. 08-1, *Revenue Arrangements with Multiple Deliverables*. Respondents also note that estimated prices would be required less frequently if the Boards specify appropriate units of accounting for performance obligations.
77. Some respondents note that the use of estimates should be constrained only if estimates cannot be made reliably.
78. Many respondents, particularly in the construction industry, think that allocating the selling price is impractical for continuous-delivery contracts and inappropriate because the performance obligations typically are interdependent and not priced separately. They prefer allocating on a basis that reflects a contract-wide margin.

### ***Subsequent measurement***

79. Most respondents agree that performance obligations should be remeasured *only* when a contract is deemed onerous (which is when the costs of satisfying a performance obligation exceed the carrying amount of the performance obligation).
80. In contrast, nearly all insurers disagree with remeasuring performance obligations only when deemed onerous.

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For insurance and many investment contracts the measurement of the contract assets and contract liabilities depends upon assumptions of future uncertainties: which loss events will occur, when will they occur and how much will it cost to settle the resulting losses. The same applies to other types of long term contracts which are subject to uncertainty. The principle as set out in the discussion paper does not extend to subsequent measurement as changes in contract assets and liabilities are not reflected in revenue recognition unless performance obligations are deemed onerous. We have always advocated an active basis of valuation for insurance liabilities; such a basis of valuation requires remeasurement. Accordingly, subsequent to contract inception, for all contracts, changes in assumptions should be reflected in the contract liability value. For long term contracts with uncertainty, a current best estimate of the obligations is essential to provide meaningful information to users. (CL #112)

81. A few respondents other than insurers also think that an entity should in principle remeasure performance obligations even when not deemed onerous. They also think that the initial measurements may not always continue to provide decision-useful information about the performance obligations. However the majority of those respondents do not recommend a second measurement approach and think that, for consistency and simplicity, all performance obligations in the scope of the revenue recognition standard should be measured under the same approach. A few respondents suggest that some stand-ready and other similar 'conditional' obligations might be better measured in accordance with IAS 37.

### *Onerous test*

82. Of the respondents who support an onerous test, nearly all prefer the cost test to the current price test. However, many respondents express concern regarding the practicality of an onerous test being assessed at the level of individual performance obligations (even though the Boards reached no preliminary view in the DP on that issue). The majority of respondents who comment on that issue ask that the onerous test be applied at the contract level. They think that recognising a loss on an individual performance obligation, when the contract as a whole is profitable, does not properly portray the contract.
83. A few respondents request that the Boards address the onerous test in a separate project, or suggest using the existing requirements in IAS 37 and SFAS 5. They

think that the amount allocated to a performance obligation should be remeasured only for a change in the transaction price.

## Costs

84. Many respondents think the Boards cannot issue a revenue standard without also providing cost guidance. Many users, particularly in the construction industry, focus on profit recognition, not revenue recognition. In particular, those applying SOP 81-1, IAS 11, FTB 90-1, *Accounting for Separately Priced Extended Warranties, and Product maintenance Contracts* or other service providers note their reliance on cost guidance in existing standards. They highlight instances in which, under the proposals in the DP, the entity would be precluded from recognizing revenue but would recognize expenses for costs incurred under the contract.
85. Respondents, particularly those applying U.S. GAAP, question what would happen to existing cost guidance in revenue standards. Some ask the boards to review that guidance and determine whether it would still be required, permitted or no longer applicable.

Most participants are of the opinion that the Boards must consider cost recognition in this project. Revenues and costs are both sides of the same coin when it comes to measuring profitability, and focusing solely on one side might lead to unintended consequences and reduced comparability in reported earnings. It was noted that the removal of the detailed revenue recognition rules that currently exist under US GAAP might also result in a loss of guidance on how to account for the related costs in some instances. This would presumably necessitate replacement guidance and clear disclosures of these cases, absent a more rigorous consideration of cost recognition for the project as a whole. More broadly, it was generally agreed that there was concern over a potential lack of consistency in the amount and timing of cost recognition. (CL #184)

### **Contract origination costs**

86. The majority of respondents support the proposal that contract costs should be expensed or capitalized in accordance with other standards. Examples of costs eligible for capitalization in other standards include inventory costs and software development costs. However, respondents express concerns about how existing

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standards which also provide guidance on contract origination costs (such as IAS 11 and SFAS 51, *Financial Reporting by Cable Television Companies*) would be affected by a new standard. Respondents also comment that further guidance may be needed to define an asset or what constitutes a contract origination cost (such as work performed to prepare for a current contract or marketing costs) as there is currently a lack of a single standard to address cost capitalization.

87. Many respondents think that contract origination costs should be capitalized at contract inception and amortized over the term of the contract.
88. Insurers think that contract origination costs should be recognized as expenses; however, as noted, they think that revenue should be recognized at contract inception to cover those expenses.
89. Some respondents request the Boards address costs in a separate project or within other current standards.

### **Other issues**

90. Although the DP did not ask for views on some issues, many respondents provided comments on other topics, particularly those the Boards have discussed since issuing the DP.

### ***Collectibility***

91. For those respondents who provided comments on collectibility, most think that some level of assurance of collectibility should be a criterion for determining when revenue should be recognized (rather than only as a measurement issue). For example, some support a criterion similar to the one in SAB 104 requiring that “collectibility is reasonably assured”.

### ***Uncertain consideration***

92. For those respondents who provided comments, many support the Boards’ recent decision to allow the transaction price to be estimated when the customer



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consideration is uncertain, variable or contingent. However many prefer the best-estimate approach rather than a probability-weighted approach.

93. Some respondents note that estimating contingent consideration can be unnecessarily complex and estimating uncertain consideration may decrease the reliability and comparability of financial information and will require substantial costs to ensure consistency in estimation techniques. They also think the resulting volatility of recognised revenue would be difficult for users to understand.

Overall, it is our view, that contingent consideration should be excluded from the transaction price until the amount becomes certain. The view that revenue, once recognized, will eventually be converted to a corresponding amount of cash intuitively prevails for most financial statement users and we think that any deviation from the current approach (which requires a very high level of certainty for recognition of revenue) will create confusion. Overall it is our view that the benefits of a more faithful depiction of the economics of revenue transactions that could be brought by a “measurement” approach are outweighed by the potential loss of confidence placed by investors in reported revenues. In addition, we believe that moving uncertain consideration from a recognition issue to a measurement issue would result in significant additional preparation costs for most software companies. We therefore recommend the use of a threshold for recognition instead of a probability assessment. (CL #161)

### ***Gross versus net presentation of rights and obligations***

94. For those respondents who provided comments on this issue, the majority support the net presentation of rights and obligations. A few noted that some information value may be lost with a net presentation.