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Sir David Tweedie
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International Accounting Standards Board
30 Cannon Street
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Dear Sir David,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organized standard-setting body for financial reporting and auditing standards in Austria, I appreciate the opportunity to comment on the Exposure Draft *Revenue from Contracts with Customers* (June 2010). Principal authors of this comment letter were Gerhard Prachner, Helmut Kerschbaumer, Peter Geyer and Leopold Fischl.

General Comments

We welcome the efforts of the IASB and the FASB to develop a single standard for revenue recognition for contracts with customers. Nevertheless we think that some issues need to be discussed or clarified.

We agree with the setup of the Standard (i.e main text and application guidance). However, we believe the application guidance contains certain principles which should be integrated into the main text (e.g. application guidance relating to warranties).

We also acknowledge the efforts of the boards to align the standard with the asset/liability- and control-concept in order to be consistent with the (new draft) framework and the standards completed during the past years. However, we do see a need to further clarify the application of this concept, especially with regard to control. In the present draft some of the proposed indicators for transfer of control are either not clearly linked to that concept or conflict with the actual economic substance of the transactions. Particularly when it comes to service arrangements (mainly construction and customized service contracts) we are concerned that the control principle will not be sufficiently helpful for determining the settlement of the performance obligation. It appears to us that these principles have been developed having in mind especially the sale of goods and are therefore difficult to apply to service arrangements.

Since the concepts of the proposed standard are significantly different from the ones of the previous standards and applying the proposed standard may require considerable changes in entities' accounting systems, we strongly recommend to perform further field tests on the application of the principles.

Recognition of revenue (paragraphs 8-33)

Q1 *Paragraphs 12-19 propose a principle (price interdependence) to help an entity 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 a part of the original contract.*

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

Generally we think that the principle for identifying separate performance obligations does not provide sufficient guidance on when segregation or aggregation is necessary. Moreover, we think that the price interdependence should not be the sole principle. We recommend to define the principle more clearly and to reconsider its practical consequences, particularly unreasonable costs for the segregations of contracts.

Moreover, the suggested two-step approach for the segregation of contracts and the identification of performance obligations does not appear to be generally applicable without further clarification. We also suggest including guidance under what circumstances the two-step approach is necessary and under what circumstances a direct approach is sufficient.

Q2 *The boards propose 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. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?*

We generally support the proposed guidance for separating performance obligations. But we believe that distinct goods or services shall be identified by the entity's own customary business practice rather than the business practice of any other entity (paragraph 23 ED).

Since in practice prices are often independent from each other (for example, as evidenced by price lists) we have concerns that the proposed approach could unbundle contracts into different performance obligations even if practice would not do so. To require entities to identify, separate and account for every single performance obligation in those circumstances could lead to a misbalance of cost and benefits.

We also question the information value of separating performance obligations for goods and services that are never sold separately on the market. In those situations, it is likely that, Such a

separation is arbitrary and recognizing revenue for such separated performance obligations will not appropriately reflect the business model.

Q3 *Do you think that the proposed guidance in paragraphs 25-31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?*

We generally agree with the control-approach. But we also believe that the control notion described in paragraph 30 is not fully suitable for construction contracts. Outputs and especially inputs (such as described in paragraph 33) may not mirror the effective transfer of control, e.g. if a contract sets forth that a customer takes control of a newly constructed building only after completion. Therefore, we think that the transfer of control in the construction industry should be regulated separately. We suggest that field tests for paragraph 30 are carried out for the construction industry.

Measurement of revenue (paragraphs 34-53)

Q4 *The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.*

Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

We agree with the concept of revenue recognition on the basis of estimated transaction prices. This is also in line with other standards (e.g. IFRS 3).

However, we think that the condition in paragraph 38 a) (business experience with same or similar types of contracts) may be too restrictive. In our view the condition “reasonable estimate” is sufficient because reasonable estimations may also be possible without the mentioned experience (e.g. if costs and revenues can be clearly determined). At the same time the business experience and its relevance for the contract are exposed to a wide range of interpretation and may lack objectivity.

We also suggest a clarification of paragraph 38: This paragraph shall only apply to non-fixed transaction prices.

All told, judgement relating to variable transaction prices may lead to different accounting treatments for significant revenue streams. Therefore, we propose to continue field tests and interviews to determine whether business practice and EDP systems are really prepared for such an exercise and to determine the potential cost of introducing the new standard.

Q5 *Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?*

We do not agree that the revenue recognition should reflect the customer's credit risk. We assume that entities enter into contracts only if the credit risk of the counterparty is sufficiently low (i.e. after performing a credit check) and that a reliable estimation of the (remaining) credit risk for a single contract is not practical. We question a principle transforming an exceptional case into the general rule. Accordingly, we propose to consider credit risk in exceptional cases (highly increased credit risk) and for certain contract types only (long term construction contracts).

We agree that the effect of subsequent changes in the assessment of credit risk should be recognised as income or expense rather than as an adjustment to revenue.

Q6 *Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?*

In general we agree with this proposal. However, the individual credit risk should not be included in the discount rate (see Q 5). The entity should separately present the effect of financing and revenue.

Q7 *Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?*

We agree with the proposal with regard to the contract inception. However, changes in the transaction price after the contract inception should only be allocated to the outstanding performance obligations, if these changes do not relate to already completed performance obligations.

Contract costs (paragraph 57-63)

Q8 *Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38 Intangible Assets or ASC Topic 985 on software), an entity should recognize an asset only if those costs meet specified criteria. Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?*

We agree with the proposed requirements. See Q9 for further comments on the definition of cost.

Q9 *Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation.*

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

Generally we agree with the costs specified for purposes of recognizing ‘contract assets’ and the impairment testing thereon as well as for determining onerous contracts/performance obligations.

However, paragraph 58 refers to direct costs only. For us it is not clear whether this definition, especially lit (c), does allow a systematic allocation of overheads other than administrative overheads. The definition of direct costs shall be harmonized with (or clearly distinguished from) the cost definition of IAS 2 (and IAS 11) in order to clarify similarities and differences. For case (a) (measuring contract costs) we recommend to align the definition with the definition of cost in IAS 2.10. For (b) (measuring the onerous performance obligation) we suggest referring to the “net realizable value” concept in IAS 2 (amount of the transaction price allocated to the performance obligations less the estimated cost of completion and the estimated cost necessary to make the sale of the asset).

We agree that an entity shall recognize an impairment loss (only) on a contract level basis, e.g. to the extent that the carrying amount of a contract asset exceeds the amount of the transaction price allocated to the remaining performance obligations (of this contract) less the costs that relate directly to satisfying those performance obligations. This means that impairment is recognized only if the contracts assets cannot be recovered based on the contract as a whole.

This proposed requirement is somehow inconsistent with the proposal in paragraphs 54 and 55 making the entity recognize a liability for onerous performance obligations at the individual performance obligation level. This proposal could result in the recognition of losses although the contract as a whole is still profitable. Especially due to the potentially significant judgment necessary for allocating contract revenues and contract cost to individual performance obligations, we recommend that a liability for an onerous performance obligation should only be recognized if the contract as a whole is onerous.

Paragraph 13 also requires the combination of contracts under certain circumstances. We think the accounting implication relating to impairment of such combined contracts should also be addressed in the standard.

Disclosure (paragraphs 69-83)

Q10 *The objective of the boards’ proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?*

We think that the proposed disclosure requirements will meet that objective. However, they are excessive in certain parts. For example, the reconciliation of contract balances in paragraph 75 might be useful. But the required information may not be easily available for many entities. Disclosure requirements in paragraph 75 may be integrated in paragraph 74 (e.g. paragraph 75 a) (i) and (ii)).

We also think that the information about performance obligations in paragraph 77 sufficiently meets that objective if only reported on an aggregated level.

Generally, we recommend that the boards include clear disclosure objectives rather than requiring specified detailed disclosures. Entities in specific industries and circumstances can then use judgement in order to make disclosures meeting these objectives.

Q11 *The boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.
Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?*

We agree that this is useful information and that the disclosure requirements should be limited to contracts with an original expected duration of more than one year. This is consistent with other information about maturities in the financial statements and should also be applied to interim reporting.

Q12 *Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why?*

We generally agree. However, we recommend to clarify the relationship of such information with the disclosure requirements of IFRS 8, (in particular in paragraph 32 of IFRS 8) and to explain whether such information sufficiently meets the objective of this disclosure requirement.

Effective date and transition (Paragraphs 84 and 85)

Q13 *Do you agree that an entity should apply the proposed requirements retrospectively (ie as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why?
Is there an alternative transition method that would preserve trend information about the revenue but at a lower cost? If so, please explain the alternative and why you think it is better.*

We agree in principle. However, reasonable approximations should be explicitly permitted with respect to determining the cumulative effects of the change on the opening balances of the earliest period presented and the effects on the comparative amounts disclosed. This is especially the case for long term construction contracts where the entity would be required to segregate contracts that were entered into many years ago.

Application guidance (paragraphs B1-B96)

Q14 *The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?*

We welcome additional guidance, especially relating to the more complex topics of revenue recognition. However, certain guidance included in B1 – B96 (e.g. B32 and B33) appears to also contain basic principles which should be included in the main text of the standard. Moreover, the examples in the application guidance should be shorter and less detailed. Additionally, we miss the structure of the application guidance. Therefore, we recommend reviewing the application guidance for potential improvements.

Q15 *The boards propose 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. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.*
- (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation to transfer the product specified in the contract.*

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for the product warranties and why?

We do not fully agree with the concept of the proposed accounting for a warranty that provides a customer with coverage for latent defects in the product.

Example 4 suggests that the entity has to recognize an asset with respect to the products relating to performance obligations which the entity has not satisfied. In our opinion, this is not in line with the basic concept of the standard because the respective (defect) products have been transferred to the customers and the customers have obtained control of those products. The remaining performance obligation normally relates to specific parts of the product only and in most cases the product will not be exchanged but repaired or completed. Therefore, we suggest accounting for the unsatisfied performance obligation on a net basis, e.g. measuring the performance obligation using the estimated amount to satisfy the expected defects.

We acknowledge that the boards have included additional guidance in B18 on how to assess whether the objective of the product warranty is to provide a customer with coverage for latent defects in a product or to provide a customer with coverage for faults that arise after the product is transferred to the customer. However, in practice it is difficult to distinguish between both situations because entities provide coverage for faults that arise within a certain period after the sale of the product without distinguishing whether the fault already exists when the product is transferred to the customer or thereafter.

Q16 *The boards propose the following if a licence is not considered to be a sale of intellectual property:*

- (a) if an entity grants a customer an exclusive licence to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation; and*
- (b) if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer the licence and it satisfies that obligation when the customer is able to use and benefit from the licence.*

Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

We agree with the distinction between exclusive and non-exclusive licenses. For exclusive licenses we recommend to apply the same principles and rules as proposed for the upcoming IFRS on leases.

Granting a non-exclusive license should not always lead to revenue recognition at the time an entity grants a customer such license, but in line with the term of the license. In case of licenses granted with no time limit (e.g. the sale of a standard computer software) revenue should be recognized when the customer is able to use and benefit from the license. For licenses granted for a limited time period only (e.g. the right to use a trademark for five years) revenue should be recognized over the term of the license.

Consequential amendments

Q17 *The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?*

We agree with this proposed requirement.

Please do not hesitate to contact me if you wish to discuss any aspect of our comment letter in more detail.

Kind regards,

Romuald Bertl
Chairman