



OICV- IOSCO

Organización Internacional de Comisiones de Valores  
International Organisation of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organização Internacional das Comissões de Valore

**December 7, 2010**

Exposure Draft: Revenue from Contracts with Customers  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

**RE: Exposure Draft: Revenue from Contracts with Customers**

Dear IASB Members:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (Standing Committee No. 1) thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board (IASB or the Board) Exposure Draft: *Revenue from Contracts with Customers*.

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Standing Committee No. 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Standing Committee No. 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

**General Observations:**

We support the proposal's objectives, which include providing a more robust framework for addressing revenue recognition issues and reducing the sources of accounting guidance that preparers must consult in preparing financial statements. While we support the overall direction and objective of the project, we have provided some feedback on certain aspects of the proposal where we have some concerns. Two of those matters are noted below and the remainder are provided as responses to the Boards' questions.

The proposed Standard intends to replace the risks and rewards approach with a control approach, by which revenue is recognized when control over goods and services is transferred to the customer. We recommend that consideration be given to expanding the existing examples to make them more complex as well as possibly adding examples to help illustrate various aspects of the proposed model. For example, given the complexity involved in many software arrangements, we suggest the Boards

Calle Oquendo 12  
28006 Madrid  
ESPAÑA  
Tel.: (34.91) 417.55.49 • Fax: (34.91)  
555.93.68  
mail@oicv.iosco.org • www.iosco.org

consider providing an example(s) illustrating some of the anticipated issues for software arrangements. In this regard, we believe that guidance addressing when control transfers in various types of software arrangements may be of particular importance.

Additionally, we anticipate that companies will encounter difficulties in the implementation of the control model with regard to long-term contracts, both with contracts for which control is transferred continuously, as we also noted in our response to Question 3 (see below), and with long-term contracts for which control is not transferred continuously. We are concerned that without proper guidance on how to determine when control is transferred, in both cases, the application of the proposed principles to long-term contracts might result in delayed revenue recognition for such contracts. This may lead, sometimes, to inappropriate recognition and presentation of transactions in the financial statements. We are concerned that the economic substance of these long-term contracts would not be reflected, thus causing the reported results within an entity's financial statements to be, to a certain extent, much less relevant.

Therefore, we would appreciate the Boards adding some clarifications and guidance for determining how to apply the control model to long-term contracts of both types, each with regard to their specific characteristics, in a manner that captures their economic substance.

### **Responses to the Board's Questions**

#### **Question 1:**

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 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?

#### **Response:**

We suggest the following amendment to the first sentence in paragraph 13 to clarify, if true, that the combining guidance pertains to performance obligations that exist in segmented contracts.

“An entity shall combine two or more contracts or performance obligations located in separately entered contracts or segmented contracts as discussed in paragraph 15”

Additionally, while we note the guidance provided in Example 1 in the Application Guidance section, we suggest consideration of whether further guidance can be provided to better explain the underlying principle for combining contracts. The Boards have provided more direct guidance for segmenting a contract, as illustrated by the specific conditions noted in paragraph 15 that must be met in order to segment a contract. We suggest clarifying whether it was the intention to establish different thresholds (higher for segmenting) for combining and segmenting contracts.

#### **Contract Modifications**

We support the guidance for contract modifications, that is, reflecting the cumulative effect of the modification only if the pricing of the modification is interdependent with the existing contract.

We believe that certain clarifications to paragraph 19 are needed. Particularly, we think that there is a need to clarify if and which of the three criteria set forth in paragraph 13 are relevant to assessing

whether a modification and the existing contract are interdependent, as we feel the criteria set out in paragraph 13, as worded, are less relevant in the case of contract modifications.

**Question 2:**

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?

**Response:**

We agree with the principle expressed in paragraph 23 for determining when a performance obligation is considered distinct. However, we suggest the following clarifications:

- We suggest clarifying whether goods or services from separate contracts that are not combined can be bundled to arrive at a bundle that is distinct, or whether goods and services can only be bundled within a single contract or when the contracts are combined.
- We suggest clarification between “sells” as used in paragraph 23(a) and “regularly sells” as used in paragraph 15 (segmenting guidance) and whether “sells” is purposely establishing a lower threshold. In this regard, we suggest the Boards clarify whether “sells” would perhaps capture the sale of goods or services under any circumstance (e.g., distressed sale).

We suggest considering whether paragraph 24 is necessary as it does not appear to be providing incremental guidance. In this regard, an entity wouldn't be able to determine whether accounting for goods or services transferred at the same time would differ from accounting for those goods separately unless the entity first performed an analysis of the impact under both methods. If paragraph 24 is not removed, we suggest the Boards clarify that an entity must still perform an onerous test separately for each performance obligation.

**Question 3:**

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?

**Response:**

Given that the revenue recognition methods noted in paragraph 33 should only be used when goods and services are transferred continuously, such a determination could have a material effect on revenue recognition. However, for long-term construction contracts it is usually difficult to judge whether customers obtained control of a partially completed product or partially provided services. We expect that entities will encounter difficulties in this determination and suggest providing more guidance on whether control is transferred continuously.

We suggest adding “customer acceptance” to paragraph 30 as an indicator of a customer obtaining control.

We suggest the inclusion of language in paragraph 31 such as “None of the preceding indicators *necessarily by themselves* determines...”

While we note a sale of a software license example is provided in paragraph 45, we believe it is still not sufficiently clear as to when control will transfer in more complex software arrangements. We suggest

providing a more detailed software example in the related application guidance given potential difficulties in the application of the transfer of control principle to many software arrangements.

**Question 4:** 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?

**Response:**

While we support a threshold of only recognizing revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated, we suggest providing guidance in the basis for conclusions to better understand the threshold of “reasonably estimated.”

While we understand there are merits to requiring performance of an onerous test at the performance obligation level, we also believe there may be equally as strong benefits to performing the onerous test at the contract level. As such, we suggest additional consideration be given to the proposed approach. Regardless, we suggest expanded discussion in the basis for conclusions regarding the Boards’ consideration.

With regard to the onerous test required to be performed in accordance with paragraphs 54 through 56, we suggest clarifying whether 1) any liability that would be recognized is first offset against any asset capitalized in accordance with paragraph 57 or other asset associated with the performance obligation or the contract (e.g., inventory), or 2) any liability for an onerous performance obligation is reflected strictly as a liability, that is, assets capitalized in accordance with paragraph 57 and other assets associated with the performance obligation or contract are not reduced as a result of the performance obligation onerous test.

**Question 5:**

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?

**Response:**

As we understand it, a transaction may be comprised of two elements – a sale transaction and loan (credit) transaction, and therefore should be reflected in the financial statements this way. We believe that credit risk should not be considered in a manner similar to other variable consideration and should therefore be excluded from the determination of transaction price. In this regard we believe most contracts already take into account customer credit risk and believe there are superior ways of providing credit risk information to financial statement users. We are also concerned about a loss of information regarding credit risk under the proposed approach, which does not separately display the amount of credit losses. We believe that reflecting credit losses in revenue will impair a financial statement user’s ability to analyze the entity's performance and to evaluate its operational efficiency and thus will make it harder for users to compare between companies.

We are concerned that as currently written, the guidance in paragraphs 43 and 44 regarding collectability and time value of money may be confusing. For example, we note in the penultimate sentence in paragraph 45 that the discount rate used should reflect both credit risk and time value of money. We suggest considering whether these two paragraphs could be re-written to better express the intended approach.

As noted above, we believe that credit risk should not be reflected within revenue. However, if the Boards ultimately decide to adopt the proposed model, we believe that segregated disclosure should be added, by customer type, of the quantified effect of credit risk on the original contract price as well as changes to contract price. Some members believe, however, that this latter approach will add unnecessary complexity as compared to an approach that excludes credit loss adjustments from the measurement of revenue.

**Question 6:**

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?

**Response:**

We support separately reflecting financing components, whether explicit or implicit. We suggest removing the notion of "material" from the guidance since a notion of materiality is inherent in all aspects of accounting and not unique to this guidance. If the notion of "material" remains, we believe the Boards should clarify whether an assessment of materiality would be limited to a legal contract-by-contract assessment, after combining and segmenting contracts, or to all contracts with a single customer. Likewise, we believe the Boards should clarify whether the assessment of materiality can be made at a higher level, such as a class of customer, the entire population of contracts, or on the financial statements taken as a whole.

**Question 7:**

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?

**Response:**

We support allocation of transaction price to all separate performance obligations in a contract in proportion to stand-alone selling price. With regard to the discussion in paragraphs BC 122-125 addressing the use of the residual method, it is unclear whether the residual method is considered an appropriate approach by which stand-alone selling price can be determined. Specifically, the following language found in paragraph BC 125 appears to be contradictory, "...the residual method should not be used to allocate the transaction price to separate performance obligations. However, the boards noted that a residual technique may be an appropriate method for estimating a stand-alone selling price if there is a directly observable price for one performance obligation but not the other." While we do not necessarily have a preference about the use of the residual method, we suggest clarifying the Boards' intention.

**Question 8:**

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 recognise 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?

**Response:**

We believe the proposed requirements for accounting for the costs of fulfilling a contract are operational and sufficient. However, we have the following suggestions:

- Clarify the basis for considering the costs included parenthetically in paragraph 57(a), that is, costs that relate to a specific contract under negotiation. We are concerned that these costs do not meet the definition of an asset. Additionally, including these costs would seem to support capitalizing costs associated with arrangements that are not considered to be “contracts” under paragraph 11 (wholly unperformed contracts that can be terminated without penalty). If this is the intent, we recommend clarifying that despite not being able to consider the arrangements as contracts under paragraph 11, certain related costs should still be capitalized.
- Clarify, if true, that the intention in paragraph 57 is for an entity to apply that guidance if accounting guidance is not provided in other literature as opposed to applying the guidance in the Revenue standard in addition to that provided in other literature.
- Consider amending the language in paragraph 61 from “amortized on a systematic basis consistent with...” to the language used in paragraph 31, that is, “that best depicts the transfer of goods or services to the customer.”

**Question 9:**

Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation. Do you agree with the costs specified? If not, what costs would you include or exclude and why?

**Response:**

We support the costs specified in paragraph 58. See also our response to Question 4.

**Questions 10 and 11:**

**Question 10:** 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?

**Question 11:** 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?

**Response:**

We generally support the proposed disclosures but have the following suggestions:

- While we note the principle of not including variable consideration in the transaction price unless reasonably estimable, we support additional disclosure regarding the quality of consideration (e.g., if the consideration is a mix of fixed and variable, if the probability-

weighted range is unusually wide, if the estimate is being made for a single, highly uncertain contract, etc...) included in the transaction price.

- We suggest additional disclosures regarding the quality of the estimate of sales returns (e.g., wide range of outcomes) notwithstanding that an entity may be able to arrive at an estimate that is considered “reasonably estimated” as discussed in paragraph B10.
- Clarify, if true, that the one-year duration is based upon the expected performance period and not the stated contract period.
- Clarify whether the reference to “contract” means a legal contract or an individual segment of a segmented contract.
- Clarify, if true, that the disclosure requirements in paragraph 77 apply to each performance obligation, even if two or more performance obligations were not accounted for separately, pursuant to the provisions of paragraph 24. See also our response to Question 2.

**Question 12:**

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?

**Response:**

We understand that entities will need to use significant judgment in deciding how best to disaggregate revenue disclosures. However, we have the following suggestions to improve the guidance:

- We note that the example of customer type (government versus nongovernment customers) listed in paragraph 74(c) is quite broad and may not provide useful disaggregated information. Consider revising this example so as not to provide comfort as to its use in practice. We would expect most entities to provide a greater level of disaggregation than simply “government” versus “nongovernment.”
- Paragraph 78 requires disclosure for outstanding performance obligations only for contracts with durations of more than one year. In paragraph BC179(d), the Boards note that this disclosure would enable users to obtain consistency in reporting of “backlog,” which is often calculated on a variety of bases. Although paragraph BC180 notes that this information is mainly useful for longer-term contracts, it is unclear what cost/benefit analysis was performed to choose a bright-line cut-off for contracts with durations of more than one year. The reporting of backlog is common in various industries, and the disclosure provided in management commentary normally relates to all backlog, not just those contracts with durations of more than one year. Since this information is often being provided, it is unclear why the Boards have concluded that this bright-line cut-off is needed for disclosure purposes particularly if the gap is likely to be filled through additional discussion in management commentary.

**Question 13:**

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 revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

**Response:**

Some members support the proposed retrospective transition provision and believe that it will enable users to analyze trends in an entity's position and to compare the current year's performance with previous years. These members also believe that the provisions of IAS 8 provide a suitable solution in cases in which companies experience practical difficulties in applying the ED's principles retrospectively. One member disagrees with the proposed transition. That member would instead support prospective transition citing the difficulty and cost to implement a retrospective transition, especially in cases involving long-term contracts that extend back several years. If the Boards were to require retrospective transition, preparers should be given enough lead time to implement that approach.

**Question 14:**

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?

**Response:**

We suggest providing additional guidance for milestones and points and loyalty programs as follows:

Application guidance for milestone contract accounting would be helpful if it were to provide discussion on how to treat non-refundable payments received for milestone completion when the milestone is not a separate performance obligation, or a discussion of factors to consider when assessing whether goods and services associated with a milestone could be considered a separate performance obligation. We suggest providing, as implementation guidance, a comprehensive example of an arrangement including an unconditional payment.

For points and loyalty programs there is a brief discussion in paragraphs B24 and B25 on the topic, but it would be helpful if the Boards would provide additional guidance on the estimation process and considerations for identifying the value of these performance obligations at inception as well as the subsequent accounting for a change in estimation for points that will never be used (e.g., are there situations when amended point consumption estimates could be subsequently recorded as revenue).

**Question 15:**

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 in addition to the 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 product warranties and why?

**Response:**

As contemplated by the Boards during deliberations, we expect some difficulty in distinguishing between the two classes of product warranties but believe that practice will evolve (or already exists) to deal with the requirement (e.g., an entity may consider all defects that occur within one year as latent). Nonetheless, we think some guidance on how to differentiate between the two types of warranties is needed. Additional guidance might help the formalization of relevant practices, as well as prevent the evolvment of inappropriate practices.



**Question 16:**

The boards propose the following if a license 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 over the term of the licence; 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 license is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

**Response:**

Our understanding is that the Boards' guidance pertaining to licenses was intended to be consistent with the Boards' decisions in the leasing project. Given that the approach in the leasing project has changed, we suspect that the Boards will consider those changes and incorporate them in this guidance. We suggest ultimately providing discussion about why, if true, there is a divergence from the general revenue model for licenses.

To the extent that the guidance proposed in the ED is carried forward to a final standard, we suggest that the Boards provide additional guidance clarifying the substantial differences between exclusive and non-exclusive rights and why different methods of recognition are needed. We reference the premise in the leasing project that a lease comprises an asset representing the lessee's right of use and a liability representing the lessee's obligation to make payments. We question whether such arrangements are substantively different from licensing arrangements such that different accounting should result, as currently proposed.

**Question 17:**

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?

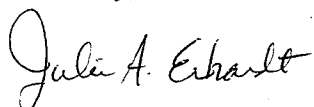
**Response:**

We do not object to the application of the model in accounting for the gain or loss on the sale of non-financial assets such as intangible assets and property plant and equipment.

\* \* \* \*

We appreciate your thoughtful consideration of the comments raised in this letter. If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at 202-551-5300.

Sincerely,



Julie A. Erhardt

Chairman

IOSCO Standing Committee No. 1