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International Accounting Standards Board
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Technical Director, File Reference No. 1820-100
Financial Accounting Standards Board
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Re: Exposure Draft - Revenue from Contracts with Customers (the "exposure draft" or the "proposed standard")

We are pleased to respond to the invitation by the IASB and the FASB ("the boards") to comment on the exposure draft, *Revenue from Contracts with Customers*, on behalf of PricewaterhouseCoopers. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of those member firms who commented on the exposure draft. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We agree with the boards' objective to establish principles for recognising revenue that provide clearer and more consistent guidance. We agree that a single, contract-based revenue recognition model will help achieve this goal. The proposed standard should increase comparability of revenue recognition practices between entities and industries, better align revenue recognition principles with the conceptual frameworks, and further advance the boards' convergence efforts.

We agree with the theoretical merit of many of the concepts included in the proposed standard. There are a number of situations, however, where the concepts may be difficult to apply, do not appear cost beneficial, or both. The scale of change that might be required for some entities to adopt a new revenue standard leads us to question whether the boards, as part of their redeliberations, should consider a more practical approach in areas such as: (1) identification and separation of distinct performance obligations; (2) measurement and presentation of the impact of credit risk on revenue; (3) the impact of the time value of money on revenue recognition; and (4) accounting for warranties. We recommend that the boards determine whether the intended benefits of changes in these areas are outweighed by the incremental process, systems, and other costs that they may impose. We also agree with the boards that full retrospective application of the proposed standard might benefit users, but a more pragmatic approach to transition might likely be needed in many situations. We encourage the boards to allow for early adoption of the proposed standard. We have suggested some practical alternatives in our responses to the boards' questions in Appendix A.



Contract combination, segmentation, and modification

We agree that two or more contracts should be combined and accounted for as a single contract if the contracts are interdependent, but price interdependency should not be the only consideration. Price interdependency should be considered in conjunction with the other indicators in the exposure draft.

We believe it is not necessary to segment a single contract into two or more contracts, and find the proposed accounting for segmentation difficult to understand and apply. The proposed standard is based on recognising revenue when separate performance obligations are satisfied. There would be no need to segment contracts if distinct performance obligations are accounted for separately and there is clear and well understood guidance for the treatment of contract modifications and adjustments to variable consideration.

We believe that the proposed guidance for contract modifications is not operational and will not be well understood by preparers and others. Modifications arise only when the economics of the original contract change. We recommend including additional factors in the final standard to help entities determine whether a modification changes the original contract or represents a new contract. We have suggested factors to consider in our response to Question 1.

We agree that recognising the cumulative effect of a modification might be appropriate in some situations, but there are situations where prospective treatment might better reflect the economics of the modification. Judgment is required to determine whether prospective or cumulative treatment is appropriate, and the accounting should reflect the facts, circumstances, and economic substance of the modification.

"Distinct" performance obligations

We agree with the proposed definition of a performance obligation, that separate performance obligations in a contract should be identified, and that constructive obligations can be performance obligations. We also agree that performance obligations should be accounted for separately only if they are distinct. This requires judgment and may be difficult to determine. The indicators proposed by the boards help to identify distinct performance obligations, but are incomplete. The additional indicators suggested in our response to Question 2 would promote consistency. We also recommend that the boards omit distinct profit margin from the list of indicators for both practical and conceptual reasons.

The exposure draft proposes a model under which all performance obligations are identified first, and then aggregated into distinct performance obligations. This approach might not reflect the economics of transactions and might not always be operational. Separate performance obligations should be identified by disaggregating the contract into distinct performance obligations, not the other way around.



Transfer of control

We agree that revenue results from the satisfaction of performance obligations, which occurs when control transfers, whether of a good or a service. The proposed standard demonstrates this principle for goods, but additional indicators are needed to understand when control transfers in arrangements beyond those involving tangible products. Judgment will be required to determine when control transfers in these situations. Including additional indicators in the final standard would help entities determine when control of a service has transferred to a customer and increase consistency in application. We have suggested additional indicators in our response to Question 3.

Transaction price

We agree that revenue should be recognised when the transaction price can be reasonably estimated, but we believe the estimation guidance is too restrictive. Either a probability-weighted or best estimate approach should be permitted, so entities can select the method that best reflects the economics of a transaction. We also agree that consideration paid to a customer is a reduction of the transaction price unless the entity receives a separately identifiable benefit from the customer.

There will be circumstances in which it is difficult to estimate variable consideration. We believe, however, that vendors may often have a reasonable estimate of the variable consideration they expect to receive in exchange for the goods or services transferred. We suggest emphasising that variable consideration can be reasonably estimated unless insufficient history exists to make a reasonable estimate. Changes in the estimate of variable consideration should be allocated to all performance obligations in a contract except when the variable consideration substantively relates to a specific performance obligation. Changes that substantively relate only to a specific performance obligation should affect the revenue allocated to that performance obligation, which would eliminate the need for segmentation guidance.

Cost guidance

We believe cost guidance ideally should not be included in a revenue standard. It should be included in other standards containing asset or cost guidance. We understand, however, the effect the proposed standard will have on existing cost guidance, particularly under U.S. GAAP. We therefore accept the inclusion of cost guidance in the revenue standard as a pragmatic interim measure.

The proposed standard requires that costs of obtaining a contract be expensed as incurred. This might contradict existing guidance for intangible assets in some situations. We do not believe costs of obtaining a contract, whether paid to a third party or directly to the customer, should be expensed as incurred in all situations. We recommend that the boards consider all relevant guidance to determine whether consideration paid to acquire a customer contract creates an intangible asset.

Onerous performance obligations

We do not agree with the inclusion of onerous performance obligation guidance in the revenue standard. Provisions for onerous performance obligations are cost accruals, not an issue in the recognition or measurement of revenue, and thus should be addressed in the relevant liability or contingency standards.



We strongly disagree with the boards' statement that the proposed standard will not result in a significant change to existing practice for most entities. The proposals will have a significant effect on current practice and will likely be impractical to apply in many circumstances.

We are concerned that the proposed guidance might not reflect the economics of transactions in a number of situations, particularly when an individual performance obligation is not profitable but the overall contract is profitable. We have included some examples to illustrate our concerns in our response to Question 9.

If the boards decide to retain this guidance in the final standard, we recommend that the assessment of whether an onerous provision exists be performed at the contract level or higher. The requirement to consider or remeasure onerous performance obligations each reporting period will likely be impractical for many entities and we believe the benefits of doing so will not outweigh the costs or effort. The boards should also consider whether measuring provisions for onerous performance obligations using all of the direct costs that relate to satisfying that performance obligation reflects the economics of these arrangements, or whether provisions for onerous performance obligations should be measured using only the directly incremental costs of fulfilling the obligation.

Licences

The accounting for licences of intangible assets and leases of tangible assets should be consistent, as these arrangements are economically similar, and we encourage the boards to reconcile the accounting between the two models. The proposed standard is inconsistent with the proposals for lease accounting and also appears inconsistent with the performance obligation concept underpinning the exposure draft. We recommend that the boards describe the performance obligation that they believe exists when an exclusive licence has been transferred. We are aware that there is currently diversity in practice in accounting for licences, and we therefore accept the proposed model for accounting for licences of intangible assets as a pragmatic interim solution that should achieve greater consistency. A more comprehensive solution that can be applied to both tangible and intangible assets should be developed when the boards' timetables permit. We have additional concerns with the proposed guidance in this area, and these are explained in our response to Question 16.

Disclosures

We understand the boards' objectives of improving disclosures, but the proposed disclosure requirements appear excessive. Useful information might be obscured by the volume of detailed disclosures required by the proposed standard. We have provided some suggestions in our responses to Questions 10, 11, and 12.

Application/implementation examples

We appreciate the efforts made by the boards to include application guidance and practical examples. Additional application guidance, including more complex examples, would be beneficial, and we have provided suggestions in our response to Question 14.



Other issues

Our answers to the specific questions in the exposure draft provide more detail on the views expressed above and are attached in Appendix A to this letter. Other considerations are included in Appendix B.

If you have any questions, please contact John Hitchins, PwC Global Chief Accountant (+44 207 804 2497), Tony de Bell (+44 207 213 5336), Paul Kepple, PwC US Chief Accountant (+1 973 236 5293), or Brett Cohen (+1 973 236 7201).

Yours faithfully,

PricewaterhouseCoopers LLP



Appendix A - Responses to questions

Question 1

Paragraphs 12-19 propose a principle (price interdependence) to help an entity determine whether to:

- (a) combine two or more contracts and account for them as a single contract;*
- (b) segment a single contract and account for it as two or more contracts; and*
- (c) 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?

We agree with the proposed principle for combining two or more contracts and accounting for them as a single contract if the contracts are interdependent. We support the concept of interdependency as a principle, but price interdependency should not be the only consideration. Price interdependency is one indicator of whether contracts are interdependent, and therefore should be considered in conjunction with the indicators provided in paragraphs 13 (a), (b), and (c).

It is not necessary to segment a single contract and account for it as two or more contracts. The guidance in the proposed standard is based on separate performance obligations. The final standard will be operational, and will not need to contain guidance on contract segmentation, if it requires distinct performance obligations to be accounted for separately and includes the principles for contract modifications and variable consideration described below.

We believe, however, that the proposed guidance on contract modifications is not operational and will not be well understood by preparers and others. Modifications arise when the economics of the original contract change, for example, when there is a change in the promised consideration or goods or services to be provided, or because of renewals or extensions. Factors that indicate a modification alters the economics of an existing contract might include:

- The modification results in the delivery of additional goods or services for consideration at other than a current market price
- The modification results in a change in consideration for satisfied performance obligations
- The modification affects the deliverables under the existing contract, or there is price interdependency between the additional deliverables and the deliverables under the existing contract
- The modification is the result of a renegotiation of the original contract terms

We agree that accounting for the cumulative effect of a modification might be appropriate in some situations. There are also situations where prospective treatment might better reflect the economics of the modification. Judgment is required to determine whether prospective or cumulative recognition is appropriate, and the accounting should reflect the facts and circumstances of the modification. We



recommend including a principle and related factors in the final standard to help preparers capture and report the economic impact of the modification appropriately.

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?

We generally agree with the proposed definition of a performance obligation, that separate performance obligations in a contract should be identified, and that constructive obligations can be performance obligations. Constructive obligations might not always be legally enforceable (e.g., when-and-if upgrades), but we believe such obligations represent performance obligations and we suggest this be clarified. Identifying performance obligations that should be accounted for separately requires judgment and may be difficult, particularly in a service arrangement.

It is unclear whether the existence of a performance obligation should be determined based on the perspective of the vendor or the customer. The definition of a performance obligation could be clarified by adding that a performance obligation represents the good or service that the customer reasonably expects to receive when entering into a contract based on the contract terms and customary business practices.

The exposure draft proposes a model that calls for all performance obligations to be identified first, and then aggregated into "distinct" performance obligations. This might not reflect the economics of the transaction and in many circumstances might not be operational, such as with some construction contracts. We recommend that separate performance obligations be identified by disaggregating the contract into distinct performance obligations, not the other way around.

The criteria in paragraph 23 are prescriptive and not consistent with a principles-based standard. We also question why a distinct profit margin should be considered in determining whether a good or service not sold separately is distinct. We suggest the following principle be used:

A performance obligation is distinct if it represents a discrete offering by the vendor or a discrete purchasing decision by the customer.

Indicators that a performance obligation is distinct could include:

- The goods or services are sold separately by the entity or other entities in the entity's principal market or a similar market
- The goods or services are delivered to the customer at different times
- The performance obligation can be satisfied independently from other performance obligations in the contract
- The goods or services are not highly interrelated



We also suggest clarifying that no single indicator determines whether a performance obligation is distinct and that the indicators should be considered in their entirety.

It is unclear why the inclusion of contract management services affects the assessment of whether performance obligations are distinct, as suggested by example 11 of the application guidance. Management services may be sold separately, so it would be helpful to understand when such services should be considered in determining whether other performance obligations in the contract are distinct.

We disagree with the illustration of a distinct service in example 23 of the implementation guidance. The example concludes that product placement services provided by the customer are a distinct performance obligation separate from the sale of the product(s). In our view, payments for placement of a product that is purchased from the vendor are not distinct from the purchase of the product.

The notion of distinct appears to be the criteria for separate recognition when payments are made to a customer in exchange for goods or services to be provided by that customer. This is the principle applied in example 23 to determine the accounting for the payment made to the customer. We agree with using the notion of distinct to determine whether the vendor is receiving an identifiable benefit if the definition of a distinct performance obligation is amended as described above, but we suggest that this principle is made explicit.

The Basis for Conclusion (specifically paragraphs BC50, BC53-56) includes information that is helpful in understanding when performance obligations are distinct. We recommend that this information be included in the standard rather than the Basis for Conclusions.

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?

We agree with the concept that revenue results from the satisfaction of performance obligations (i.e., when control transfers). The proposed standard and related application guidance demonstrates this principle for goods, but additional indicators are needed to understand when control is transferred in arrangements not involving tangible products. For example, does the satisfaction of the performance obligations in a service arrangement, such as transportation services, consulting services, and security services, occur continuously or only upon successful completion of the entire service?

We do not support a separate model for services (which would necessitate differentiating services from goods), but we suggest adding the following factors to the boards' indicators of transfer of control to help entities determine when control is transferred continuously to a customer in such arrangements:

- The customer immediately obtains the benefit of the entity's activities and no other customer can benefit from the entity's activities
- Each task performed by the vendor progresses toward completion of the performance obligation (i.e., there is no need to re-perform work already performed, even if vendors change) rather than where



successive tasks may not necessarily build towards a successful outcome (and a new vendor would need to re-perform the services)

Paragraph 30(a) describes one of the indicators that the customer has obtained control over a good or service, which is that the customer has an unconditional obligation to pay. We suggest amending that indicator to state that payment is unconditional once the services are performed, even if the amount to be paid is uncertain.

We recommend that the indicator described in paragraph 30(d) be clarified. We recognise that it is similar to the guidance in IFRIC 15, which is intended to help an entity determine whether goods or construction services are being sold, but the guidance does not determine whether control is transferred continuously. We recommend that the indicator explain that control might be transferred continuously if the contract terms are so specific to the customer that the seller is acting under the direction of the customer and is compensated for following those directions.

Judgment will be required to determine when control transfers, particularly in a service arrangement. We suggest amending paragraph 31 to state explicitly that the indicators should be assessed in their entirety, and it is unlikely that meeting only one factor will be sufficient.

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?

We agree that revenue should be recognised using an estimated transaction price. It will be difficult in some circumstances to estimate the amount of variable consideration, but we believe that vendors may often have a reasonable estimate of the variable consideration they expect to receive in exchange for the goods or services transferred. We therefore recommend amending the guidance to state that variable consideration can be reasonably estimated unless insufficient history exists to make a reasonable estimate. The wording might be adjusted as follows:

38. An entity shall recognise revenue from satisfying a performance obligation ~~only if~~ unless the transaction price ~~can~~ cannot be reasonably estimated. The transaction price ~~can~~ cannot be reasonably estimated ~~only if~~ either ~~both~~ of the following conditions are met:

- (a) the entity has limited or no experience with similar types of contracts (or does not have access to the experience of other entities if it has no experience of its own); ~~and or~~



- (b) the entity's experience is not relevant to the contract because the entity ~~does not~~ expects significant changes in circumstances.

We note, however, that even if the boards were to make our recommended changes, there would continue to be instances where variable consideration may not be reasonably estimated at the inception of an arrangement. These might include success-based milestones, such as those dependent on regulatory approval, and revenues based on future customer sales for products that have yet to be commercialised.

We recommend that the boards address how to account for situations when the criteria for recognising a financial asset are met but the criteria for recognising revenue are not met. This could be the case when the definition of a financial asset is met under financial instruments guidance but revenue cannot be recognised because the performance obligation has not been satisfied or the consideration cannot be reasonably estimated. It is unclear whether the balance sheet should be grossed up to reflect the financial asset and contract liability.

The final standard should permit the transaction price to be estimated using either a probability-weighted approach or a best estimate. A best estimate might better reflect the economics of the transaction in certain situations, such as when there are binary outcomes. We understand the theoretical merits of the probability-weighted approach, but believe that it is not useful or operational in all situations and that the benefits of using the probability-weighted approach would not outweigh the costs or efforts when a single best estimate can be determined readily. A probability-weighted approach might also reflect an exit price at the date of the transaction rather than the consideration the entity expects to receive from the customer in exchange for transferring goods or services, and might be contrary to the transaction price approach required by the exposure draft.

Multiple element arrangements might include variable consideration. In some situations the variable consideration might be attributable to all elements in the arrangement, but in others the variable consideration might relate to a specific performance obligation. Changes in the estimate of variable consideration should be allocated to all the elements in a multiple element arrangement based on the original transaction price allocation ratio, except when it is clear that the variable consideration substantively relates to a specific performance obligation. Changes in the estimate of variable consideration that relates to a specific performance obligation should be reflected as an adjustment to revenue relating to that performance obligation.

For example, an entity may have a contract to construct a bridge and then a road, with a performance bonus for early completion of the bridge. The performance bonus represents variable consideration, but is clearly attributed to the completion of the bridge by a specified date, and not to the bridge and road together. Any changes in the estimate of the performance bonus should be attributed to only the bridge in this example.

We agree with the principle that consideration paid to a customer is a reduction of the transaction price unless it is a payment for a distinct good or service. See our response to Question 2.



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 not?

We agree that conceptually a customer's credit risk should affect the measurement of revenue rather than the recognition of revenue. We disagree, however, with the proposal to recognise subsequent changes in the assessment of credit risk in other income or expense. Subsequent adjustments should be recorded in revenue. This will align the revenue recognised with cash ultimately received from the customer, consistent with other areas of the model, such as changes in variable consideration. This information is beneficial for financial statement users who are interested in reconciling revenue with the net cash ultimately received from the customer and would be more operational.

It might be difficult, however, for some entities to implement the proposed guidance because it will require changes to systems and processes, and the benefit might not outweigh the cost. We suggest the boards consider a simpler solution that allows entities to continue to record bad debt expense separately from revenue. This would avoid the need to make changes to systems and other processes for what will primarily be a change in the geography of where bad debt expense is recorded.

The exposure draft limits revenue recognition to those amounts that can be reasonably estimated, which appears to include reasonable estimation of collectibility as well as variable consideration. It would be helpful if this was clarified in the final standard.

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?

We understand the conceptual merits of adjusting the transaction price to reflect the time value of money if the contract includes a material financing component, but the practical challenges will likely outweigh the benefit to users. Consider an example of a customer loyalty arrangement where consideration is received in full at the time of the original sale but the customer loyalty points are not redeemed until a future date. It will be challenging in this situation to determine if the financing component is material to the contract, and extremely difficult to measure the consideration attributable to the loyalty points, including the effect of the time value of money. Similar challenges might arise in long-term arrangements where revenue is recognised continuously and payments are made in a pattern that differs from the satisfaction of the performance obligations. We believe that the transaction price should not be adjusted for the time value of money in most circumstances. In our view, the transaction price should only reflect the time value of money when payment of cash is significantly delayed after control of the good or service transfers. This would reduce the practical challenges of adjusting the transaction price to reflect financing.



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?

We agree that relative stand-alone selling prices of goods or services underlying performance obligations should be the basis for allocating the transaction price. The relative stand-alone selling price approach provides the most reasonable basis for the allocation of the transaction price to separate performance obligations in a contract. In many cases, entities should be able to estimate stand-alone selling prices of goods or services, even if the items are not sold separately, if they represent a distinct good or service (or bundle of goods and/or services).

We acknowledge that it might be difficult in some situations to estimate stand-alone selling prices and that stand-alone selling prices are not available for every performance obligation in a contract. The key is that the accounting should reflect the economics of the transaction and the substance of any discount. There are several methods that might be used to make the estimate. We agree with the boards' comments in BC125 that the residual method should not be an alternative methodology to the stand-alone selling price for allocating the consideration, but it might, in some circumstances, be an appropriate way to estimate a stand-alone selling price in the absence of any other evidence. It should be used only when it reflects the economics of the transaction and is a reasonable approximation of the stand-alone selling price. We suggest incorporating this guidance into the standard or the implementation guidance.

We encourage the boards to consider whether it is acceptable for entities with large populations of customers, like those in the telecommunication or automotive industries, to allocate the transaction price to performance obligations based on a portfolio of similar contracts rather than at the individual contract level, provided this reflects the economics of the transactions and is a reasonable approximation of the stand-alone selling price of individual contracts. This will provide a practical expedient for entities in many circumstances.

There might be situations where discounts are commonly provided to all customers or to particular classes of customers. We suggest that these customary discounts be considered when estimating stand-alone selling prices. There are also situations where the number of performance obligations that will need to be satisfied is unclear. For example, gift cards might be sold to a population of customers. Experience indicates that 90 percent of gift cards will be redeemed. We suggest that the consideration relating to the 10 percent of gift cards not expected to be redeemed either be allocated ratably to the gift cards that are redeemed or be recognised when the gift cards expire. It would be helpful for the final standard to clarify if either or both of these approaches are acceptable.

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 not?

We believe that cost guidance ideally should not be included in a revenue standard. It should be included in other standards that contain asset or cost guidance. We also believe that the costs of fulfilling a contract that do not meet the definition of an asset under IFRS or U.S. GAAP should not be capitalised, even if they are incurred solely as a result of entering into a contract.

Any clarification of the accounting for costs under IFRS that is required by the withdrawal of IAS 11 and IAS 18 can be addressed through consequential amendments to existing standards (IAS 2, *Inventories*, IAS 16, *Property, Plant, and Equipment*, and IAS 38, *Intangible Assets*). We acknowledge the need for additional cost recognition guidance under U.S. GAAP due to the lack of a single standard addressing the capitalisation of property, plant, and equipment and the fragmented guidance for other assets (e.g., inventory and intangible assets). There may also be insufficient guidance in the U.S. standards once certain capitalisation guidance currently included in industry specific revenue recognition literature is withdrawn. We therefore accept the inclusion of cost guidance in the revenue standard at this stage, but we recommend that the boards comprehensively review the cost guidance that exists under both IFRS and U.S. GAAP to ensure that the guidance is sufficient to accomplish the boards' objectives.

The proposed standard uses a hierarchy to determine whether costs can be capitalised. It also suggests that amounts that would be expensed as incurred under specific asset standards might be recognised as assets under the revenue standard, but this is not clear. For example, the asset guidance in IFRS specifies that training costs are expensed as incurred. It is unclear whether training costs would then be capitalised under the revenue standard if they meet the criteria in paragraph 57 of the exposure draft. Pre-production costs incurred in long-term supply arrangements (e.g., design and development costs for moulds, dies, and other tools that an automotive supplier will not own but that will be used in producing products for its customer) may only be capitalised under U.S. GAAP (ASC 340-10-25) if they meet certain criteria. Those criteria include the supplier having a non-cancellable right to use the moulds, dies, and tools during the supply arrangement or a legally enforceable contractual guarantee for reimbursement. Otherwise, such costs are expensed as incurred. The requirement to expense these costs might be inconsistent with the proposed standard.

The proposed standard requires that costs of obtaining a contract be expensed as incurred, which might contradict existing guidance in some situations. Consideration paid to a customer to secure a contract might be capitalised under existing guidance as an advance discount and amortised against revenue from that customer. Consideration paid to a third party to obtain a contract might be capitalised under existing guidance and amortised as an operating expense. There are a number of industries, such as investment management and telecommunications, where significant amounts are paid to third parties to obtain a contract with a customer and the related cash flow stream. In most cases it is likely that future cash flows will be more than sufficient to recover the outflow. In some cases, amounts paid to third parties (or to the customer) may also be clawed back if the customer contract is not satisfactorily completed.



We recognise there is diversity in practice today in accounting for both of these costs. It would be helpful for the boards to consider all of the relevant guidance to determine whether costs paid to acquire a contract creates an intangible asset, as the guidance is not sufficiently clear to result in consistent practice.

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?

We agree that most of the costs specified in paragraph 58 should be capitalised when they relate to assets used to satisfy a performance obligation. We recommend, however, amending paragraph 58(e), "other costs that were incurred only because the entity entered into the contract (for example, subcontractor costs)" to clarify that only those costs that meet the definition of an asset should be capitalised. This category is vague as written, and may allow for wide interpretation and possible inclusion of costs that would not meet the definition of an asset. We also suggest that the standard clarify that direct costs relate to a specific contract (e.g., not numerous contracts or general contract activities). Costs specified should be consistent with costs that are capitalised in accordance with other standards (i.e., IAS 2, *Inventories*, IAS 16, *Property, Plant and Equipment*, IAS 38, *Intangible Assets*, and equivalent guidance in U.S. GAAP).

We do not agree with the inclusion of guidance for onerous performance obligations in the revenue standard. Provisions for onerous performance obligations are cost accruals, not an issue in the recognition or measurement of revenue, and should be addressed in the relevant liability or contingency standards.

If onerous performance obligation guidance is retained in the revenue standard, we are concerned that the economics of transactions will not be reflected in a number of situations, particularly when an individual performance obligation is not profitable but the overall contract is profitable. Consider the following examples:

- An entity sells computers, monitors, and support services to a customer in a bundled sale that is profitable. Each performance obligation is distinct, but the cost of the support services exceeds the allocated transaction price based on relative stand-alone selling prices. The exposure draft would require the recognition of a loss for the support services at the inception of the contract despite the contract being profitable overall.
- An airline will often price individual tickets to maximise the number of seats sold on each flight. The airline might significantly discount ticket prices to maximise the profitability of each flight due to the high fixed costs of flying. The onerous performance obligation guidance would require the airline to record a liability for an onerous performance obligation when tickets are sold at an amount that does not cover all of the costs of that seat, as specified in paragraph 58, despite the airline having made an economically rational decision to sell those tickets at that price.
- Asset management fees may be based on a percentage of the net asset value of a fund at a particular point in time. It might not be possible to make a reasonable estimate of the variable consideration at the inception of the contract, therefore no revenue is recognised. The proposed standard appears to require an entity to recognise a provision for onerous performance obligations, as the known costs



exceed the estimated revenue at inception. This might result in the accrual of all of the future operating costs under the contract, such as employee costs, etc., at the inception of the contract and reversal of those costs when the revenue can be reasonably estimated.

- An entity enters into a contract to sell printers to a retailer at a price less than the entity's cost because of the expectation of follow-on profitable sales of ink. The exposure draft would require the entity to record a provision at contract inception (or possibly sooner if the inventory is impaired) for all printers expected to be sold, irrespective of the expected profitability of the sales of ink.

The accounting for onerous performance obligations is likely to be a significant issue for: (1) entities that have high fixed costs where transactions are often priced to cover incremental costs; (2) entities whose revenue includes significant variable consideration; and (3) entities whose business models involve selling goods or services at a loss in order to attract other more profitable sales. We do not believe accruing for onerous performance obligations in such cases best reflects the economics of these arrangements. Contrary to the boards' comments in BC133(a), the proposed accounting for onerous performance obligations likely will result in a very significant change to much of existing practice.

If the onerous performance obligation guidance is retained in the revenue standard, the assessment of whether a liability should be recorded should be performed at the contract level or potentially at a higher level, such as a customer relationship level when the entity obtains benefits beyond the individual contract. This may provide a better reflection of the underlying economics of the transaction. The boards should also consider whether measuring provisions for onerous performance obligations using all of the direct costs that relate to satisfying that performance obligation reflects the economics of these arrangements, or whether provisions for onerous performance obligations should be measured using only the directly incremental costs of fulfilling the obligation.

Assessing performance obligations each reporting period to determine whether they are onerous will be impractical for many entities. Costs might not be tracked at the performance obligation level, therefore the allocation of costs to individual performance obligations and the assessment of whether performance obligations are onerous will take considerably more time and effort than making an assessment at the contract level or higher. We do not believe the benefits of making an assessment at the performance obligation level will outweigh the cost or effort.

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?

It is difficult to assess the adequacy of the disclosures required for any item in the financial statements when the disclosure requirements are specified in each standard rather than in accordance with a clear disclosure framework. An overarching framework that specifies the objectives of the disclosures in the financial statements and how these might be achieved would simplify the identification of disclosures in each area. We encourage the boards to develop a disclosure framework as soon as their timetables will allow.



We believe the proposed disclosure requirements will not meet the boards' objectives and will not improve existing disclosures. There is a danger that useful information will be obscured by the volume of detailed information required by the proposed standard.

Many of the proposed disclosures appear to duplicate information already required under various existing standards. For example, the proposed requirement in paragraph 74 to disaggregate revenue might duplicate the entity-wide disclosures required by the segment reporting standards. We suggest that the boards identify and require disclosure of useful information for users that is not provided by existing disclosure requirements.

We do not believe the roll-forward disclosure of contract balances proposed in paragraph 75 is useful and the disclosure objective satisfied by this disclosure is not clear. This will add significantly to the volume of disclosures and may require entities to develop new systems to capture the necessary information. We suggest that the boards reconsider the cost of this proposal compared to its benefit and identify the specific information provided by this reconciliation that is both useful and not required by existing standards.

We suggest that appropriate disclosures might be:

- A description of the principal sources of revenue and the accounting policies applied to each significant revenue stream;
- A description of the significant estimates and judgments made in connection with the recognition and measurement of revenue and the extent to which revenue in the current period is affected by changes to those estimates; and
- A quantitative analysis of the revenue derived from each principal source, disaggregated as we have suggested in our response to Question 12.

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?

We recommend that information about performance obligations that will be satisfied in future periods not be required to be presented in the financial statements. This information may not be decision-useful, and it would be impractical to present this information if it is not already prepared and used to manage the business. In that case, entities would be required to develop systems to capture the information solely for the purpose of this disclosure.



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?

We agree that an entity should disaggregate revenues in the way that best depicts how the amount, timing and uncertainties of revenue and cash flows are affected by economic factors. This disclosure should be specific to each entity and should reflect the information about revenue that is used to manage the business.

Question 13

Do you agree that an entity should apply the proposed requirements retrospectively (i.e., 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's better.

We understand the theoretical merit of applying the proposed requirements retrospectively to increase consistency across periods presented. It might not, however, be practical to apply the effects of the change in accounting principle retrospectively for a number of entities. Factors such as the existence of long-term contracts, contracts with multiple performance obligations, variable consideration, a significant number of contracts, or other items that require a significant degree of estimation will make retrospective application difficult and impractical. Retrospective application could require an entity to recreate information that it did not capture at the time the transaction was entered into, causing management to make subjective estimates about conditions that existed at that date and increasing the potential for the inappropriate use of hindsight. These estimates could reduce the relevance and reliability of the financial statements. The cost of retrospective application also might outweigh the benefits to users.

We suggest that, as a practical expedient, the final standard include language that would allow preparers to apply the impracticability exception in a wider range of situations. We also recommend that appropriate lead-time be provided to enable entities that can apply the standard retrospectively sufficient time to put in place the necessary systems to capture information.

The boards have proposed that entities not be permitted to early adopt the revenue standard before the mandatory adoption date. We suggest the boards permit early adoption for all entities. If the boards decide nevertheless to prohibit early adoption, we recommend that IFRS first time adopters, entities doing initial public offerings, and entities emerging from bankruptcy be permitted to early adopt the final standard to avoid another change in revenue accounting policies in a relatively short timeframe.

We are also concerned about the timing of adoption of the revenue standard in conjunction with the other new standards the boards are currently developing. The revenue standard requires that a contract that is partially within the scope of the revenue standard and partially within the scope of other standards be



accounted for by first applying the separation and/or measurement requirements of the other standard. The boards should address the interaction between standards when the standards might be effective at different times or do not consistently require retrospective application.

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?

The application guidance is helpful in applying the principles in the proposed standard, but certain of the examples may be too simplistic to assist entities applying the proposed standard in many practical situations. Additional application guidance would be helpful to promote more consistent application of the principles. We suggest that the application guidance incorporate situations that better reflect the difficulties and judgments that exist in many transactions.

The boards might consider whether application guidance for the following situations would be helpful:

- A performance obligation that is conditional and in the control of the vendor, such as when-and-if upgrades
- Activities that the entity would have performed absent the obligation in the contract, such as defending a patent underlying a licence
- Transportation services, where it is unclear whether control of the transportation service transfers continuously or only upon delivery
- Transactions in the financial services industry, including various service fees
- Repurchase agreements or sales that include a residual value guarantee
- Time value of money in multiple element arrangements and when there is continuous transfer of control (to the extent the principle of accounting for time value of money is retained in a final standard)
- Breakage in a single element arrangement, such as gift cards
- Circumstances where consideration is received from a party other than the direct customer (e.g., grocery coupons accepted by a retailer but redeemed by a manufacturer)
- Circumstances where performance obligations are provided to a party other than the direct customer (e.g., loyalty points provided to credit card customers)
- Arrangements that involve non-refundable up-front fees, payments for research services, milestone payments that are contingent on achievement of specific targets, and revenues based on future customer sales

It might be helpful to have an example of how the standard is applied when there is a contract with multiple performance obligations, some of which are in the revenue standard and others that are in the scope of financial instruments, insurance, or leasing standards. It might also be helpful to have an example illustrating the disclosures required by the final standard.



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?

We agree that there are two types of warranties and that a warranty for latent defects is, in substance, a failed sale while a warranty for faults arising after the sale is a separate performance obligation. We believe, however, that it is not practical or cost beneficial to apply a failed sale model to warranties over individual components when both models require the deferral of revenue. Determining whether a defect is latent or the result of normal wear and tear is often difficult, and may not be practical for some entities. It is also difficult to determine the appropriate accounting when either the customer or the vendor can select to settle the warranty by paying cash rather than replacing or repairing the item. We therefore suggest that all warranties (other than those settled in cash) be accounted for as distinct performance obligations with revenue recognised as those obligations are satisfied. This is a practical solution that will result in accounting broadly consistent with the boards' proposals.

As a practical alternative, if all warranties are not treated as separate performance obligations, we recommend keeping the current model and accounting for standard warranties for latent defects using a cost accrual model.

Question 16

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 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 licence is exclusive? Do you agree with the pattern of revenue recognition proposed by the boards? Why or why not?



There should be consistent accounting for licences of intangible assets and leases of tangible assets, as these arrangements are economically similar. We encourage the boards to reconcile the accounting between the two models.

The proposed model appears inconsistent with the performance obligation concept underpinning the exposure draft. It is unclear why the pattern of revenue recognition is based on whether the customer receives exclusive rights to the intellectual property when no additional service or obligation is required from the licensor or why an approach that focuses on the consumption of the underlying asset does not better reflect the economics of the transaction. If the proposed model is included in a final standard, the boards should explain the nature of the performance obligation when an exclusive licence has been granted for less than the asset's economic life. It would also be helpful for the boards to explain why the accounting for an exclusive licence that can be sold repeatedly (e.g., a licence to operate coffee shops in a particular geography) is different than the accounting for a non-exclusive licence (e.g., software licences).

It would be helpful to clarify how exclusivity and economic life should be determined in accounting for a licence of intellectual property. The implementation guidance provides some insight into how exclusivity might be determined, but we recommend the boards provide a principle to determine when a licence is exclusive and how to define the economic life of the asset.

An entity will also need to determine whether a licence is distinct from other explicit and implicit performance obligations in a contract. It may be difficult to identify the performance obligations in contracts with highly interrelated goods or services, as often occurs with licences of intellectual property provided with other services. The more highly interrelated the goods and services in the contract, the less likely that the licence will be distinct. Licences that are not distinct will need to be accounted for in conjunction with the other goods or services in the contract. It would be helpful to clarify this in the final standard, and supplement the guidance in example 8.

There is currently diversity in practice in the accounting for licences. Notwithstanding our prior observations, we accept the boards' proposal as an interim solution to achieve greater consistency in accounting for licences of intellectual property until a more comprehensive solution is developed that can be applied to both tangible and intangible assets.

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?

We agree that the principles included in the proposed standard should be applied to a sale of non-financial assets that are not part of an entity's ordinary activities. The proposed standard provides a reasonable model for recognising the gain or loss on the sale of non-financial assets and will increase consistency in financial statements. The Basis for Conclusions (BC 251) states that this guidance does not apply to the sale of a business. It would be helpful to clarify this in the scope paragraph of the standard.

**Question 18**

[FASB only] Should any of the proposed requirements be different for non-public entities (private companies and not-for-profit organisations)? If so, which requirement(s) and why?

The proposed standard should apply to all entities that enter into contracts with customers. Allowing non-public entities to apply a different revenue standard will not increase consistency among entities and will further divide the public and private markets. However, the extent of the disclosure requirements should be considered as the increased disclosure may not be cost beneficial for private company reporting.



Appendix B - Other issues

Consistency of accounting principles

We continue to be concerned about the inconsistent accounting for economically similar transactions and the inconsistent principles developed in different standard setting projects. For example, the accounting for costs to obtain a contract or the accounting for revenue recognition for leases/licences of tangible and intangible assets should be similar, irrespective of what standard is applied, as the economics are similar. We encourage the boards to reconcile accounting principles for economically similar transactions across projects.

Definition of "revenue"

We suggest that the final standard include a clear definition of "revenue." This will help distinguish performance obligations that represent revenue generating activities from other liabilities in contracts with customers. It should also help achieve consistency in what is classified as revenue as opposed to gains or other income in the performance statement.

Scope

The proposed standard excludes "non-monetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange...". We disagree with this exclusion. Non-monetary transactions should be excluded only if there is no economic substance to the transaction. Non-monetary exchanges between entities that are not in the same line of business should be assessed for economic substance, as entities that are not in the same line of business might also enter into non-monetary exchanges for commercial reasons. It is also difficult to apply the proposed criterion to entities that have multiple lines of business.

Principal and agent considerations

The proposed standard for determining whether an entity is acting as a principal or as an agent may result in changes compared to today's model. The boards should consider whether this is what they intended. The proposed guidance states that if an entity obtains control of the goods or services of another party before it transfers those goods or services to the customer, the entity is acting as the principal in the arrangement. Indicators are provided to help an entity identify when it is acting as an agent. We are concerned that the proposed guidance may result in inconsistent application. Existing guidance in both IFRS and U.S. GAAP provide indicators of whether an entity is acting as a principal, and we believe those indicators provide a sound basis for determining whether an entity is acting as a principal or an agent. We therefore suggest that the boards consider including the existing language in the final standard. This would make it clear that having control of the goods or services before they are transferred is an indicator that the entity is acting as a principal, not a presumption.

Effect on other standards

We note that some of the provisions of the proposed standard appear to conflict with other standards, including industry guidance under U.S. GAAP. Examples include the recognition of cost of sales when



revenue is recognised (IAS 2.34) if control of the inventory transfers at a different time than revenue is recognised, and the accounting for regulated operations (Topic 980-605-25). In the absence of the boards providing the consequential amendments to other guidance that would result from the proposed standard, we are unable to assess the effect or provide any comment. We strongly encourage the boards to fully vet any such consequential changes or amendments prior to finalisation of the proposed standard. We would welcome the opportunity to participate in any such vetting.