Ernst & Young Centre
680 George Street
Sydney NSW 2000 Australia
GPO Box 2646 Sydney NSW 2001

Tel: +61 2 9248 5555
Fax: +61 2 9248 5959
www.ey.com/au

The Chairman
Australian Accounting Standards Board
PO BOX 204
Collins Street
West Victoria 8007

3 April 2012

Dear Mr Stevenson

Ernst & Young's global submissions to the IASB on the Exposure Drafts – Revenue from Contracts with Customers and Transition Guidance, Proposed amendments to IFRS 10 (ED/2011/7)

Please find enclosed the following Ernst & Young's global submissions to the IASB :

1. Exposure Draft – Revenue from Contracts with Customers (as referred to in our letter to you dated 13 February 2012)

2. (ED/2011/7) Exposure Draft – Transition Guidance, Proposed amendments to IFRS 10

Yours sincerely

Ernst & Young

Ernst & Young

Encl:

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under Professional Standards Legislation

Ernst & Young

Ernst & Young Global Limited
Becket House
1 Lambeth Palace Road
London SE1 7EU

Tel: +44 [0]20 7980 0000
Fax: +44 [0]20 7980 0275
www.ey.com

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

13 March 2012

Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT
06856-5116, USA

Dear IASB and FASB members,

Invitation to comment – Exposure Draft, *Revenue from Contracts with Customers*

The global organization of Ernst & Young is pleased to respond to the revised Exposure Draft (ED), *Revenue from Contracts with Customers*, issued by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (collectively, the Boards) on 14 November 2011. In Appendix A, we respond to the questions the Boards raised in the proposal.

We continue to support the Boards' intention to develop a converged revenue recognition standard for IFRS and US GAAP, and we agree with the principle of requiring an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. While we believe the Boards have made significant progress addressing the concerns raised by constituents about their 2010 exposure draft, more work needs to be done to enable consistent application. We have set out our concerns in more detail and have highlighted a number of issues regarding application of the proposal, including our observations on the consequential amendments, in Appendices A through D.

While we welcome the additional outreach performed by the Boards to help them understand how the proposal would affect different industries, we think it is critical that the Boards carefully evaluate feedback on all aspects of the proposal and not limit redeliberations to matters related to the six questions they raise in the ED. For the proposal to be operational, the principles and implementation guidance must work effectively for all types of revenue that arise in contracts with customers. We believe the Boards should incorporate additional implementation guidance into the final standard to facilitate consistent application.

Further, once the final standard is issued, we recommend the Boards form one or more working groups (potentially different groups for different industries) to address implementation issues as they arise, particularly during the transition phase. Applying the proposal would require significant judgment for many arrangements that previously were not made, or were made within a different framework, and we believe the Boards have an important role in ensuring that consistent interpretations develop in practice. In the absence

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of direct involvement by the Boards, we believe ad hoc working groups may develop within industries and jurisdictions to try to develop some level of consistency in application. We believe that these efforts would be more effective if conducted under the auspices of the Boards.

Our most significant concerns with the ED are summarized below.

Performance obligations satisfied over time

We generally agree with the principle of revenue recognition based on the transfer of control either at a point in time or, in certain circumstances, over time. As described below and in our response to Question 1 in Appendix A, we are concerned that an entity could determine that it has met the proposed criteria for recognizing revenue over time when, in reality, control transfers and revenue should be recognized at a point in time.

In particular, we are concerned by views we have heard in certain jurisdictions that the proposed model to recognize revenue over time would be applied broadly to a large number of contracts with customers, including some contracts where revenue is currently recognized over time as an entity performs activities for a customer. We believe it is important for the Boards to emphasize in the final standard that the proposed model for recognizing revenue over time is based on the transfer of control and is not an activity-based approach.

Further, in our view, the proposed model to recognize revenue over time when a customer does not gain control of an asset while it is created or enhanced is not helpful when applied to contracts involving a bundle of goods or services. Specifically, we recommend that the Boards revise the proposed guidance to explain why the lack of alternative use of a good or service is substantive (or relevant) in determining whether control of that good or service transfers over time.

Variable consideration

The proposal requires significant use of estimates, particularly in determining the transaction price when the consideration is variable. We support the changes made by the Boards in response to concerns about the methods used to estimate variable consideration. However, we believe the Boards should provide more application guidance on this aspect of the model and we have a number of questions about the proposed accounting for variable consideration. We have provided a number of illustrative scenarios in Appendix B for which we believe the application of the model is unclear. We believe further clarification is needed to minimize the potential for diversity that we anticipate would otherwise develop in practice.

Constraining the cumulative amount of revenue recognized

We believe constraining the cumulative amount of revenue recognized is appropriate when there is significant uncertainty about the amount of revenue the entity will be entitled to receive. However, as described below and in our response to Question 3 in Appendix A, we believe further guidance dealing with the effects of this constraint is needed. For example, we recommend that the Boards provide further guidance on recognizing costs when revenue

is not recognized because the amount of the consideration to which the entity will be entitled is not "reasonably assured." We also believe further guidance is needed to illustrate the application of this guidance for arrangements containing both fixed and variable consideration.

Regarding the effect of the constraint on the recognition of costs, if revenue amounts are not reasonably assured, as described in paragraphs 81-85, it does not appear that the costs associated with the transferred good or service would be deferred even if the entity believes those costs are recoverable. The guidance in paragraphs 93(c) and 93(d) suggest that the costs could not be capitalized (because they relate to or cannot be distinguished from a satisfied performance obligation). We question whether this result is consistent with the economics of a contract that is expected to be profitable.

As another example, paragraph 98 would require an entity to amortize contract costs on a systematic basis consistent with the pattern of transfer of goods or services under the contract. It is not clear whether the "pattern of transfer" of goods or services would be affected by the constraint on revenue recognition. That is, should amortization be deferred or accelerated when revenue is not recognized as a result of the constraint on revenue, even though the good or service may have been transferred to the customer?

We believe these examples demonstrate the need for the Boards to clarify the interaction of the constraint on the amount of revenue that can be recognized and the treatment of the related costs. We note that paragraph 48 would permit the recognition of revenue to the extent of costs incurred for performance obligations satisfied over time when an entity cannot develop a reasonable measure of progress to completion. Broadening the application of this guidance to situations when revenue is constrained may be one alternative for the Boards to consider.

Please also refer to our response to Question 3 in Appendix A for additional comments.

Onerous performance obligations

We continue to believe that the onerous test, if included in the revenue standard, should be conducted at the contract-level rather than the performance obligation-level, and we urge the Boards to reconsider this decision. We believe the proposal fails to reflect the economics of a typical contract with a customer and results in the inappropriate recognition of liabilities when an overall contract is profitable.

The Boards' rationale for assessing onerous arrangements at the performance obligation level is that different margins are revealed by the identification of separate performance obligations, so the unit of account for the onerous test should be the same. We believe separating the transaction price (which is estimated for the contract as a whole) based on distinct margins is an allocation exercise, not a recognition issue. Conceptually, we believe recording a loss for a performance obligation in an otherwise profitable contract could confuse financial statement users because it would not reflect management's strategies for pricing different elements in a contract. For example, an entity may decide to provide a good or service at a loss to obtain a customer because the overall contract with the customer will result in a profit. In this example, recognizing a loss on the good or service provided to

obtain the customer would not appropriately reflect the economics of the contract or management's overall strategy.

Please refer to our response to Question 4 in Appendix A for additional comments on the onerous test and see Appendix D for our comments on the interaction of the onerous test with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

Disclosures

We support the Boards' objective of requiring disclosures that help users understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

However, we are concerned that the Boards' have developed the proposed disclosures without an overall disclosure framework. Creating disclosure requirements on a standard-by-standard basis with no overarching framework likely will result in excessive or overlapping disclosures. We urge the Boards to perform additional field testing of the proposed disclosures with preparers and users in different industries to make sure the disclosures included in the final standard provide decision-useful information that can be prepared at a cost that does not outweigh the benefits.

As we discuss more fully in our response to Question 5 in Appendix A, we also are concerned that the proposed disclosures could be inconsistent with the information management uses to operate the business. Consequently, the disclosures may not be helpful to users and may make the financial statements less transparent.

These concerns are magnified by the number of disclosures that would have to be provided at significant costs to preparers. In addition, the proposed interim disclosures seem particularly excessive and are inconsistent with the principle in ASC 270, *Interim Reporting*, and IAS 34, *Interim Financial Reporting*. As the Boards consider the appropriate level of interim period disclosures, they must consider the usefulness of the information provided to users of the financial statements as well as practical effects on entities, including accelerated reporting deadlines for interim results.

Applying the model from the seller's or buyer's perspective

We have observed a lack of consistency in the ED regarding when the accounting is based on the seller's perspective or the customer's perspective. For example, an entity could provide a good or service to a customer as an incentive in a contract. If assessing from the seller's perspective, the good or service could be excluded from the scope of the proposed model if the good or service is not an output of the entity's ordinary activities. Conversely, from the customer's perspective, the good or service is distinct and would be included within the scope of the proposal.

As another example, in some jurisdictions a customer obtains protective rights by law in a real estate transaction (e.g., the purchase of an apartment in a building). Such rights include substitution of the seller by a regulator in the event of default/nonperformance by the seller or legal restrictions that prevent the seller from redirecting the use of the apartment to

another customer. These rights do not necessarily provide the customer with control of the apartment, but may be considered by some to be sufficient for the seller to lose control of the apartment. If assessed from the seller's perspective, revenue could be recognized when the entity loses control (or the ability to direct the use) of the apartment. Conversely, if assessed from the customer's perspective, revenue should not be recognized because the seller has not yet transferred control of the apartment to the customer. To minimize diversity in practice, we believe it would be preferable to base the accounting throughout the model on one perspective.

However, if the Boards believe it is appropriate to base the accounting for certain aspects of the model on the customer's perspective and for others on the seller's perspective, we believe the Boards should specify within each of the five steps of the proposal when the accounting should be evaluated from the seller's perspective, the customer's perspective, or both. In addition, while paragraph 37(b) contemplates a seller's protective rights, we believe similar guidance should be provided to address whether a customer's protective rights are sufficient to preclude the seller from transferring control.

We believe identifying performance obligations from a customer's perspective can be very subjective and would require significant judgment. Current guidance often requires entities to apply this approach (i.e., to view transactions from the customer's perspective). However, entities frequently find this difficult in practice because they typically do not know all of the factors motivating the customer. We believe additional clarity is necessary for entities with similar types of arrangements to apply the proposal consistently.

Unit of account

We also note that the proposal raises important questions about the unit of account for revenue recognition. Specifically, we observe inconsistencies in the guidance. To explain, paragraph 12 specifies that the unit of account is an individual contract with a customer. However, certain steps in the proposal would be applied at a level lower or higher than an individual contract. For example, revenue would be recognized and onerous liabilities would be assessed at the performance obligation-level (i.e., lower than the individual contract-level). Conversely, the costs to fulfill a contract would be capitalized and amortized for an individual contract and any specific anticipated contracts (i.e., higher than the individual contract level). We are concerned that significant differences in the unit of account could lead to accounting results that do not reflect the economic substance of the arrangements.

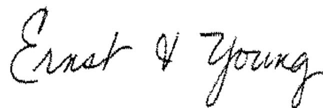
To illustrate this point, we believe paragraph 30 would permit an entity to decide to account for a long-term service contract as a single performance obligation satisfied over a period greater than one year or a succession of shorter performance obligations that are equal to or less than one year (that is, daily, weekly, monthly or quarterly) as long as the pattern of transfer is the same throughout the contract. The entity's decision would affect whether it must apply the onerous test. For example, if an entity decides that a two-year maintenance contract is comprised of two annual performance obligations, each performance obligation would be excluded from the onerous test, even if the contract is onerous. Requiring the onerous test to be performed at the contract level would be one solution to this issue (please refer to our earlier comments).

Another example of inconsistency in the unit of account relates to the guidance for estimating the transaction price, including consideration payable to a customer. The criteria proposed in paragraph 17 apply only to contracts entered into with the same customer (or related parties). However, paragraph 65 requires amounts payable to a customer's customer to be included in the estimated transaction price. It is not clear why the proposal limits the unit of account to the individual contract with a customer (and not the customer's customer) when the consideration payable to a customer's customer is included in the estimated transaction price. We believe it may be appropriate in some circumstances to combine contracts with unrelated parties when the overall economics of the arrangement cannot be understood without referring to the series of contracts as a whole.

We believe that the Boards should limit, to the extent possible, significant differences in the unit of account to reduce the likelihood that the proposal will be applied in a manner that is inconsistent with the economic substance of contracts with customers.

Should you wish to discuss the contents of this letter with us, please contact James Luke on +44 20 7951 4773 or Alison Spivey on +1 202 327 6379.

Yours faithfully,



Appendix A – Responses to the questions in the Exposure Draft, *Revenue from Contracts with Customers*

Question 1: Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognizes revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

As previously discussed, we believe revenue recognition over time is appropriate when it is clear that the transfer of control of a good or service occurs over time. We also support extending the principle for revenue recognition over time to other situations when it is clear that an entity has satisfied a performance obligation over time, although we observe that some believe the proposed approach would apply in circumstances when it is not clear that revenue recognition over time would be appropriate.

We describe below our specific comments on paragraphs 35 and 36. In particular, we are concerned that the proposed criteria for revenue recognition over time when the entity's performance does not create an asset with alternative use to the entity do not provide a clear framework that can be consistently applied to similar contracts.

Customer controls asset as it is created or enhanced

We agree that recognizing revenue over time when an entity creates or enhances an asset that the customer controls (paragraph 35(a)) is appropriate and consistent with the principle of recognizing revenue when a good or service is transferred to a customer.

However, paragraph BC91 states that the control concept is similar to the basis for percentage-of-completion accounting in US GAAP (specifically AICPA Statement of Position (SOP) 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*). We believe there can be differences between revenue recognition that is based on the transfer of control of goods or services to a customer, as proposed in the ED, and revenue recognition from an activity-based model (in accordance with SOP 81-1). That is, activities performed by an entity would not result in revenue recognition under the ED if they do not result in the transfer of a good or service to the customer. We are concerned that some entities will believe that the reference to SOP 81-1 in BC91 suggests that all contracts previously accounted for using a percentage-of-completion approach under US GAAP would automatically qualify for revenue recognition under paragraph 35(a). This is not consistent with our understanding of the Boards' intent. We therefore believe the discussion in BC91 should be amended to clarify that the two models differ (that is, SOP 81-1 is based on performance and the ED is based on control).

Entity performance does not create an asset with alternative use

Paragraph 35(b) requires the recognition of revenue over time when certain criteria have been met that indicates a customer is receiving a benefit as the entity performs under the contract. We believe the application of this approach to service arrangements will likely result in revenue recognition that is consistent with the underlying economics of the arrangement.

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In contrast, we have concerns relating to the application of this approach to arrangements involving a bundle of goods and services. Specifically, we have received feedback from entities in some jurisdictions that the application of the proposed model will result in revenue recognition over time for arrangements, such as off-plan multiple-unit developments (e.g., apartments or condominium units where major structural elements for the building are not specified by the customer), where revenue is currently recognized at a point in time based on IFRIC 15, *Agreements for the Construction of Real Estate*. This is not consistent with our understanding of the Boards' intent, and we believe the proposed requirements need to be revised, as described further below, to address this "expectation gap."

Alternative use

Paragraph 36 of the proposal provides guidance on whether an asset has "alternative use" to the entity and states that entities should consider whether the entity is unable, either "contractually or practically," to readily direct the asset to another customer. While we understand from paragraph BC94 that the Boards do not intend for the level of customization to be a determinative factor when concluding whether an asset has alternative use, the guidance, as currently written, is too broad and could be subject to financial engineering or other possible manipulation. Manufacturing contracts for standard goods could simply include a contractual clause preventing the entity from transferring the assets to another entity and recognize revenue over time as long as the entity receives payment for performance completed to date.

For example, consider the following scenario. An entity (the seller) constructs large equipment that is used in the manufacturing process of its customers. The equipment generally takes from two to five months to build. The payment terms require the customer to pay 30% at contract inception, 30% after six weeks and the remaining balance after three months. All amounts are nonrefundable unless the seller fails to perform its obligations. While the equipment is manufactured for a particular customer, the seller could make minimal modifications and sell the equipment to another buyer if the customer defaulted on its obligations. In this situation, by simply putting a clause in the contract that the seller may not transfer the equipment to another party, it appears the seller would meet the criteria for transferring control over time as long as the seller is entitled to payment for performance completed to date, even though the equipment would require little rework to sell it to another customer.

We believe that when the customer does not obtain control of an asset as it is being created or enhanced, revenue should be recognized over time only if it is clear that the entity has satisfied a performance obligation over time. Contractual limitations regarding the alternative use of an asset may not always indicate that an entity is satisfying a performance obligation over time. We therefore recommend that the Boards revise paragraph 36 to more clearly explain why the lack of alternative use of a good or service is substantive (or relevant) in determining whether control of that good or service transfers over time. We believe this

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clarification would help encourage consistent interpretation and application of the proposed principles.

We also believe Example 7 should be revised to address a scenario in which the application of the proposed model does not result in revenue recognition over time. In our experience, arrangements involving residential real estate (apartments) commonly require only nonrefundable deposits at contract inception and are not structured to compensate the entity for performance completed to date. We think the inclusion of this example, as written, contributes to the "expectation gap" discussed above.

Entity has a right to payment for performance completed to date

Paragraph 35(b)(iii) states that the entity must have a right to payment for performance completed to date and expect to fulfill the contract as promised. We understand that an arrangement would meet this requirement only if the payments the entity was entitled to receive directly correlate with the entity's performance to date. We believe this requirement may not be clear from the draft as currently written. We recommend the Boards revise paragraph 35(b)(iii) to clarify that payment for performance to date is assessed at the inception of the arrangement and that the assessment should consider whether the right to payment for performance completed to date exists throughout the entire period of performance. We believe this clarification is necessary for consistent interpretation and application to similar arrangements.

Further, we understand that the phrase "right to payment for performance" may not be clearly understood in some jurisdictions. We suggest revising the phrase to clarify that this requirement pertains to a right to *receive* payment for performance completed to date.

Other observation

Paragraph 35(b)(i) states that one of the criteria to achieve transfer of control over time is that a customer must simultaneously receive and consume the benefits of an entity's performance as the entity performs. Paragraph 35(b)(ii) similarly states that another entity would not need to substantially reperform the work the entity has completed to date if that other entity were to fulfill the remaining performance obligation. However, paragraph 35(b)(ii) appears to provide application guidance related to paragraph 35(b)(i). That is, if the customer has simultaneously received and consumed the benefits of an entity's performance then, by default, another entity would not need to substantially reperform the work completed to date. We do not believe paragraph 35(b)(ii) is necessary as a separate criterion in the proposed model and suggest the guidance be moved to paragraph IG63/IE5 (Example 6).

Should paragraph 35(b)(ii) be retained, we believe further clarification is needed to ensure consistent interpretation and application of this criterion. For example, we have received feedback that indicates some believe this criterion is only applicable to services, while others believe it is equally applicable to goods and services.

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Question 2: Paragraphs 68 and 69 state that an entity would apply Topic 310 or IFRS 9 (or IAS 39, if applicable) to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

We agree with the model's proposed treatment of a customer's credit risk. However, we believe there could be some confusion about the meaning of the term "adjacent to" the revenue line item. For example, should the effects of the customer's credit risk be presented directly below the revenue line item in the income statement, or would parenthetical presentation be acceptable? An example would help clarify the Boards' intent.

In addition, paragraph 69 indicates that collectibility should be assessed at the contract-level. This is inconsistent with ASC 310, which permits collectibility to be assessed at a portfolio-level. It is also inconsistent with IAS 39, under which the unit of account is the individual financial instrument, rather than a contract, and collectibility of receivables is assessed at the portfolio-level. We believe these inconsistencies with ASC 310 and IAS 39 highlight the operational challenges with applying the proposed model. We believe the Boards need to address the interaction of the proposed model with ASC 310 and IAS 39.

Similarly, paragraph 69 of the ED requires that "upon initial recognition of the receivable, any difference between the measurement of the receivable…and the corresponding amount of revenue recognized shall be presented in profit or loss as a separate line item adjacent to the revenue line item." However, because this paragraph is in the section of the ED that addresses collectibility, it is not clear whether this requirement for both receivables and contract assets extends to differences that do not relate to uncollectible amounts, such as differences due to the effects of the time value of money.

Consistency with other Board projects

We note that the Boards have not yet completed their joint redeliberations of the impairment approach for trade receivables in their impairment project. As a result, constituents have not been able to evaluate the overall effect of the revenue proposals on profit or loss. For example, paragraph 69 requires an entity to present any impairment of receivables (or a change in the measurement of an impairment) that does not have a significant financing component in profit or loss adjacent to revenue. However, the proposal does not specify where an entity would present any impairment of trade receivables that do have a significant financing component. Paragraph 68 indicates that the requirements of ASC 310 or IFRS 9/IAS 39 would apply. However, the Boards have yet to redeliberate on this aspect of the impairment project.

Similarly, it is not clear whether the proposed requirement in paragraph 58 to adjust the transaction price for the time value of money if the contract has a significant financing component would also affect the measurement of impairment of trade receivables. Would an

entity need to consider the effect of discounting when measuring the impairment of trade receivables and, if so, would this requirement depend on whether a significant financing component exists (as determined in accordance with the revenue model)?

We encourage the Boards to consider the interaction between the impairment project and the revenue project further before finalizing this aspect of the revenue proposal.

Question 3: Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognizes to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognize for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

We believe constraining the cumulative amount of revenue recognized is appropriate when there is significant uncertainty about the amount of consideration the entity will be entitled to receive. However, we recommend the Boards provide further guidance on the recognition of costs when revenue is not recognized because the amount of the consideration to which the entity will be entitled is not "reasonably assured."

In addition, we believe the proposed guidance in paragraphs 81-84 that limits the recognition of variable consideration to amounts that are "reasonably assured" would result in a significant change in practice for certain asset managers preparing financial statements in accordance with US GAAP. Specifically, performance-based fees generally would not be recognized on an "as if earned basis" (that is, under Method 2 in US GAAP[1]), which is current practice for many asset managers applying US GAAP, but instead closer to the point when all contingencies have been resolved (Method 1 in US GAAP[1]). We understand that financial statement users currently include performance fees recognized under Method 2 in their analyses for US GAAP-reporting entities. As part of their outreach efforts, we encourage the Boards to obtain feedback from financial statement users in this industry to determine whether the proposed change would improve the accounting for performance fees.

We also recommend the Boards provide additional guidance regarding the application of the proposed model in specific situations, as described more fully below.

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[1] ASC 605-20-S99-1, *Revenue Recognition – SEC Materials* (formerly Emerging Issues Task Force (EITF) Issue D-96, *Accounting for Management Fees Based on a Formula*).

Appendix A – Responses to the questions in the Exposure Draft, *Revenue from Contracts with Customers*

Determining whether variable amounts are reasonably assured

We are concerned about one of the considerations for determining whether variable consideration is "reasonably assured." Namely, while the guidance in paragraph 85 seems appropriate for sales-based royalties on licensed intellectual property because the total amount of consideration could vary significantly over the life of the contract, it is not clear why specific guidance is provided for sales-based royalties on licensed intellectual property but not other royalty arrangements (such as sales-based royalties resulting from the sale of equipment) or other arrangements that have similar economics. In fact, paragraph BC203 seems to establish a principle that conceptually applies to other types of revenue (that is, that "an entity should not recognize revenue for uncertain amounts until the uncertainty is resolved").

As we indicated in our 2010 comment letter, we believe that variable transaction fees that depend on future performance by the counterparty to the contract may be difficult to reasonably estimate. Therefore, rather than provide a requirement in paragraph 85 that applies only to sales-based royalties on licensed intellectual property, we believe that paragraph 82 should be amended to state that it is unlikely that an entity would be able to reasonably estimate the portion of the transaction price that depends on the future performance of the counterparty to the contract.

Were the Boards to decide to retain paragraph 85, that paragraph refers to sales-based royalties as "additional amounts" of consideration in an arrangement, which suggests that this guidance applies only when the contract with the customer also includes other (including fixed) consideration. This is not consistent with our understanding of the Boards' intent, and we suggest the wording be revised to encompass transactions that involve only sales-based royalties. Additionally, we do not think it is clear from Example 14 why the Boards concluded that trailing commissions are reasonably assured because, similar to a sales-based royalty, the receipt of future consideration is subject to the judgment of third parties in accordance with paragraph 82(a). We suggest the Boards clarify their rationale for the timing of revenue recognition in Example 14.

Allocation of transaction price for fixed and variable consideration

The proposed model requires variable amounts to be included in the allocated transaction price, subject only to a constraint on the cumulative amount of revenue recognized such that any amounts recognized must be reasonably assured. If the variable consideration is not reasonably assured, we believe the proposal would require an entity to recognize all reasonably assured amounts included in the transaction price upon satisfaction of the initial performance obligation(s) to the extent they do not exceed the amount(s) allocated to the initial performance obligation(s) and potentially have only variable amounts remaining for unsatisfied performance obligations. This could result in zero revenue recognition upon the satisfaction of those remaining performance obligations. In contrast, if variable consideration is attributable to all of the performance obligations in the contract, some may view the resulting pattern of revenue recognition for the initial performance obligation as not reflecting the underlying economics of the contract.

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If our interpretation of the allocation of the transaction price described above is consistent with the Boards' intent, we suggest including a specific example that illustrates this point. We understand that some have read this guidance to suggest that an entity separately allocates fixed and variable amounts of consideration proportionately to the performance obligations in the contract. We believe further clarification of this point is necessary to avoid inconsistent application of the proposed model.

In addition, it is unclear how to account for a transaction in which a nonfinancial asset is transferred to another party in exchange for both fixed and variable consideration. That is, should the entity transferring the asset recognize only fixed consideration at the time of the transfer and, potentially, recognize a loss upon the derecognition of the asset transferred? As outlined in a recent EITF agenda paper[2] and IFRIC agenda paper,[3] the accounting for such a transaction is unclear under both current US GAAP and IFRS, and significant diversity in practice exists today. The proposal does not clarify the accounting for these transactions and diversity in practice likely will continue. We recommend the Boards provide guidance on this issue.

Consistency with other Board projects

Last, accounting for sales with variable consideration in the proposal is not consistent with the Boards' current tentative decisions on the Leases project. For example, some leases are priced to include variable lease payments based on usage or performance (e.g., a fixed payment plus an additional payment per mile for every mile driven with a vehicle). Based on the tentative decisions in the Leases project, variable lease payments based on usage or performance would be excluded from the lessor's receivable and instead would be recognized as earned. The portion of the leased asset related to the variable consideration would not be derecognized from the lessor's balance sheet at the lease commencement date. This approach would prevent a lessor from recognizing day one losses due to variable lease payments (i.e., variable consideration).

Conversely, under the proposed revenue model, an entity could recognize day one losses upon derecognition of the underlying asset when control transfers to the customer but the consideration is not yet reasonably assured. We acknowledge the difference in measurement and recognition of revenue between the two projects, but there does not appear to be a conceptual basis for the difference in the approach for derecognizing the underlying asset. We urge the Boards to provide further guidance on derecognition of the underlying asset

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[2] Whitepaper titled "Subsequent Out-licensing of Assets Used in IPR&D That Were Acquired in a Business Combination" submitted by the AICPA to the EITF Agenda Committee in May 2011. The EITF elected not to add this issue to its agenda, noting that the transaction in question likely would fall under the scope of the joint revenue recognition project.

[3] IFRIC agenda paper 3, titled "IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets — Contingent pricing of property, plant and equipment and intangible assets: Scope and analysis of possible accounting treatments" submitted to the IFRIC in May 2011. The IFRIC decided to defer further work on this project until the Boards conclude their discussion on the accounting for the liability for variable payments as part of the Leases project.

when revenue is not recognized because the consideration to which the entity will be entitled is not reasonably assured.

Question 4: For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognize a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative do you recommend and why?

As we indicated in our comment letters on the ED issued in June 2010 and the discussion paper issued in December 2008, we do not believe a revenue standard should address the determination of whether a contract is onerous. We believe the accounting for onerous contracts should be addressed outside of revenue recognition, in the existing liabilities standards ASC 450, *Contingencies,* and IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

If the Boards decide to retain the onerous test in the revenue standard, we believe this assessment should be performed at the contract-level, not the performance obligation-level. We believe that the onerous test as proposed is not reflective of the overall economics of the contract with a customer. We urge the Boards to reconsider this aspect of the model. Our view is based on the following observations.

Potentially recognizing a "day one" loss for an onerous performance obligation in an otherwise profitable contract seems to raise concerns similar to those addressed when the Boards decided that contract acquisition costs should be capitalized (that is, why record a loss/expense before performance has been completed if the overall contract is expected to be profitable?). We believe the same concept should apply to onerous liabilities.

Also, entities do not typically enter into contracts known to be unprofitable at contract inception. Some entities may enter into contracts that increase the entity's profit but would not necessarily cover all of the costs that relate directly to satisfying the performance obligation. That is, an entity might decide to enter into this type of contract because satisfying the performance obligation would allow the entity to recover at least some of its indirect costs (for example, depreciation on machinery and equipment used to fulfill contracts with multiple customers). The proposal would require an entity to recognize an onerous performance obligation for this contract despite the fact that it improves the entity's profitability. This does not appear to reflect the true economics of the arrangement and, in our view, would not result in information that is meaningful to financial statement users.

If the Boards decide to retain the requirement to conduct the onerous assessment at the performance obligation-level, we do think the proposed change in the scope of the onerous test should help limit (but not eliminate) the number of arrangements for which a loss is recognized on individual performance obligations that are at least incrementally profitable, although we observe that there is no conceptual basis for excluding performance obligations satisfied at a point in time and performance obligations satisfied over a period of time less than one year from the onerous assessment. However, paragraph 86 should be clarified to

indicate that the phrase "satisfy over a period of time greater than one year" refers to the time between when performance begins and is completed rather than the time between when the contract is entered into and performance is completed.

We also agree with the proposed requirement that the potential loss should be measured based on the lowest cost of settling the performance obligation. However, we believe some aspects of the measurement of this liability are not clearly stated or are inconsistent with the guidance on contract costs.

For example, the proposed guidance in paragraph 87(a) states that the entity should consider the costs that relate directly to satisfying the performance obligation and references the contract cost guidance in paragraph 92. However, paragraph 87(a) is unclear about how capitalized contract costs would affect the calculation of the onerous performance obligation. That is, paragraph 92 provides guidance on the accounting for certain costs at the contract level, not the performance obligation level. Therefore, as currently written, there appears to be an internal inconsistency. We recommend the Boards clarify how costs incurred to fulfill a contract in accordance with paragraph 92 are considered in the onerous assessment. Specifically, are contract costs added or allocated to performance obligation costs determined pursuant to paragraph 87(a)?

Also, paragraph 89 implies that the impairment of a recognized contract asset affects the calculation of the loss for an onerous performance obligation. For some assets, the requirement (while not explicit) is more intuitive. For example, if an inventory item is impaired, the expected costs to satisfy the performance obligation (as described in paragraph 87(a)) would decrease. However, for costs incurred to obtain a contract (for example, sales commissions), it is not clear how the impairment of that contract asset would change the expected costs of fulfilling a particular performance obligation. While not explicitly stated, it seems appropriate for an entity to include the carrying value of contract assets in calculating the expected *remaining* costs to satisfy the performance obligation for purposes of determining the potential onerous liability. We think it would be helpful for the Boards to clarify this aspect of the model.

Last, paragraph 90 of the FASB's ED states that a not-for-profit entity would not recognize a liability for an onerous performance obligation if the purpose of the contract is to provide a social or charitable benefit. We understand from paragraph BC353 that the exception was intended to apply to contracts whose purpose is to provide a social or charitable benefit because those types of contracts may not always have a profit-making objective, and recording a liability for future losses under those contracts would be inconsistent with the objective of financial reporting for not-for-profit entities. However, providing a social or charitable benefit frequently is consistent with the overall mission of many not-for-profit entities, even when the normal daily activities are business-oriented (e.g., health care entities). We are concerned that the broad wording in paragraph 90 could result in these entities determining that even contracts that have a profit-making objective provide a social or charitable benefit because the profits are used to reinvest in the entity and further its mission. We encourage the FASB to clarify the extent to which this exception was meant to apply.

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Question 5: The Boards propose to amend Topic 270 and IAS 34 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial statements. The disclosures that would be required (if material) are:

1. The disaggregation of revenue (paragraphs 114-116)
2. A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
3. An analysis of the entity's remaining performance obligations (paragraphs 119-121)
4. Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
5. A tabular reconciliation of the movements of the contract assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128)

Do you agree that an entity should be required to provide each of those disclosures in its interim financial statements? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial statements.

As previously discussed in our cover letter, we support the Boards' objective of requiring disclosures that help users understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. However, we continue to have concerns about the extent of proposed disclosures, and we urge the Boards to perform additional field testing with preparers and users in different industries to make sure the proposed disclosures provide decision-useful information that can be prepared at a cost that does not outweigh the benefits achieved.

We believe that the proposed disclosures have been developed in the absence of an overall disclosure framework. As a result, we believe the list of specific disclosures in paragraphs 113-129 would create a "disclosure checklist" mentality that would distract from the Boards' overall disclosure objective. We think it is imperative that the Boards further clarify, perhaps through an example, that not all of the proposed disclosures are required for each annual reporting period.

In some cases, the proposed disclosure requirements do not appear to consider the information that management uses to operate the business. We question the benefit of providing such information to users. Instead, we believe that the proposed disclosure requirements should give some consideration to the information that management finds meaningful. That is, we believe it would not be appropriate for management to collect and summarize data in a particular format solely for the purpose of complying with accounting disclosure requirements. We think it is important for the Boards to consider this principle as they reconsider the required disclosures.

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In addition, due to the amount of estimation and judgment required by the proposal to estimate the timing of satisfaction of performance obligations, we also are concerned about the availability of persuasive evidence to effectively validate management's estimates and assumptions for appropriateness.

Regarding interim disclosures, we believe the proposals are excessive and unnecessary. We believe interim disclosures should provide financial statement users with meaningful information, at a reasonable cost, regarding the most significant changes in an entity's financial results since the entity's most recent annual report. Consistent with the disclosure objectives currently described in ASC 270 and IAS 34, we think the objective of interim revenue disclosures should be to supplement the annual disclosures with information about the effects of significant new contracts entered into during the interim period, as well as significant changes in judgment or estimates for existing contracts. Specifically, we do not believe the reconciliation requirements in paragraphs 117 and 128-129 or the disclosures of performance obligations or onerous performance obligations in paragraphs 118-123 are necessary to meet this objective.

In determining whether the interim period disclosures are appropriate, the Boards also need to consider the practical effects on entities, including reporting deadlines for interim results. In some jurisdictions, interim reports are required to be completed within 40 days from the end of the interim period. We are concerned that this compressed timeframe will not, in most cases, provide sufficient time for an entity to compile and prepare the proposed disclosures, subject them to a robust corporate governance process and tag them for XBRL reporting, when necessary.

In addition, we have the following concerns with the proposed disclosure requirements and request that the Boards further clarify these issues:

- Paragraphs 114 and 115 would require disclosure of disaggregated revenue from contracts with customers. This requirement has the potential to conflict with the segment reporting requirements in ASC 280 and IFRS 8, which currently require a number of disclosures about revenue, disaggregated based on the information provided to the chief operating decision maker. We recommend the Boards reconcile the current disclosure requirements for operating segments with the proposed disclosures and resolve any duplicative or conflicting requirements. We acknowledge that this may involve amending the segment guidance.

- Paragraph 117 would require an entity to disclose a reconciliation of its opening and closing contract asset and liability balances. We believe that entities would incur significant costs to track and report the information that they would be required to provide on an interim and annual basis. For example, an entity would be required to disclose cash received in its reconciliation of contract balances, but it would be difficult for an entity to track and distinguish between cash received on contract assets and cash collected on accounts receivable. We believe the costs could significantly outweigh the benefits of providing the required information and recommend the Boards eliminate this requirement.

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- As currently written, it is unclear whether the proposed disclosure requirement in paragraph 117 would apply to short-term contracts that will be fulfilled in less than one year. We question whether a reconciliation of contract asset and liability balances on short-term contracts would be helpful to users of the financial statements because the contract balances at the beginning of the period would be unrelated to the contract balances at the end.

- Paragraphs 119 and 120 would require an entity to disclose the aggregate amount of the transaction price allocated to remaining performance obligations and provide an explanation of when the entity expects to recognize that amount as revenue. This guidance (as well as paragraph 122(c)) would require entities to present forward-looking information and management predictions about future performance that would be based on information that may not be captured within the accounting systems, such as job (project) management, resource scheduling and project backlog. We question whether the notes to the financial statements are the appropriate place for those disclosures. If they are deemed necessary, the management commentary or management's discussion and analysis would be a more appropriate location for them. Due to the judgment management would have to exercise to estimate the timing of satisfaction of performance obligations, we are also concerned about the extent of evidence that will exist to effectively audit management's estimates and assumptions. Accordingly, we request that the Boards eliminate this disclosure requirement.

- Paragraph 123 would require an entity to disclose a reconciliation of the opening and closing balances of its onerous performance obligations. We believe these proposed disclosures would result in significant costs to entities to track and report the information on an interim and annual basis. For example, it would be difficult for entities to distinguish between changes in the onerous contract liability resulting from the satisfaction of a performance obligation versus changes in the onerous contract liability not related to satisfaction of the performance obligation (that is, simply resulting from changes in estimate). Further, the objective of the proposed disclosure requirement in paragraph 123 is unclear, particularly when onerous performance obligations at the beginning of the period could be unrelated to onerous performance obligations at the end. The disclosures required in paragraph 122 would seem to satisfy the overall disclosure objective described in paragraph 109. Because we believe that the disclosure objectives would be met by other disclosure requirements and the costs of providing these disclosures could significantly outweigh the benefits, we recommend the Boards eliminate this requirement.

- Paragraph 128 would require an entity to disclose a reconciliation of the opening and closing balances of assets recognized from the costs incurred to obtain or fulfill a contract. This disclosure requirement seems excessive, and the costs would likely outweigh the benefits to users. For example, the proposal would require the reconciliation to be

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disaggregated by major asset category. This would require an entity to collect and summarize data in a particular format even though this data may not be used by management or may not help users of the financial statements. If the requirement is retained, we believe the reconciliation should be required only for the aggregate closing balance, when significant.

Question 6: For the transfer of a nonfinancial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of Topic 360, IAS 16 or IAS 40), the Boards propose amending other standards to require that an entity apply (a) the proposed guidance on control to determine when to derecognize the asset and (b) the proposed measurement guidance to determine the amount of gain or loss to recognize upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement guidance to account for the transfer of nonfinancial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

While we support applying the recognition and measurement principles of this guidance to the transfer of a nonfinancial asset that is not an output of an entity's ordinary activities, we are concerned that the proposal does not go far enough in dealing with the potential issues that may arise in these transactions.

For example, there does not appear to be a conceptual basis for accounting for the sale of a nonfinancial asset (which would be measured and derecognized under the proposal) differently from the sale of an investment in a subsidiary that contains a single nonfinancial asset (i.e., a single asset entity, which would be measured and derecognized in accordance with ASC 810 or IFRS 10). Similarly, there does not appear to be a conceptual basis for the difference in accounting for the sale of a business that produces goods or services (which is measured and derecognized in US GAAP based on ASC 810) versus the sale of a hotel (which would be measured and derecognized under the proposed model). We think the Boards need to reconsider the application of the proposal in such circumstances. Please also refer to our comments on the consequential amendments to US GAAP in Appendix C for additional discussion.

Further, as previously described in our comments about variable consideration, it is unclear how an entity would account for a transaction in which an asset is transferred to another party in exchange for variable consideration that is not reasonably assured. For example, intangible assets (such as patents, mining or exploration rights) are typically sold for a small up-front fee accompanied by significant variable payments in the form of royalties based on sales of products developed using the patent or a fixed amount per unit of output generated by the asset. In these types of arrangements, would the entity transferring the asset recognize only fixed consideration amounts at the time of the transfer and, potentially, recognize a loss upon the derecognition of the nonfinancial asset transferred (that is, the patent or the mining rights)? The accounting for such a transaction is unclear under current US GAAP and IFRS, and significant diversity in practice exists today. We believe the recognition of "day one" losses under the proposal would not accurately reflect the

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economic substance of these types of arrangements and would not provide useful information to users of the financial statements.

Last, it is unclear where entities would present estimates of uncollectible amounts related to the sale of nonfinancial assets. Specifically, should uncollectible amount be presented in a line item adjacent to the gain or loss on the sale of the nonfinancial asset? We request that the Boards clarify this point.

Appendix B – Comments on other aspects of the model where the Boards were not specifically seeking feedback

Scope

Paragraph 10 would exclude contracts where the counterparty is a collaborator or partner in the arrangement. However, the proposed US GAAP consequential amendments to ASC 808 specifically refer to the implementation guidance in the revenue proposal to account for collaboration arrangements. As a result, the intention of the scope exclusion is not clear. Further, under IFRS it is even less clear because no specific guidance on these arrangements exists but the scope limitation implies that applying the proposed revenue model by analogy would be inappropriate. We recommend that the Boards include the recognition of revenue for goods or services transferred to customers through a collaborative arrangement in the scope of the proposed model if the arrangement is not captured by guidance in another standard.

Identifying the contract

We have certain observations and suggestions about the guidance for identifying the contract with the customer.

Multiple parties to a contract

It is not clear how the proposal would apply to contracts involving a party other than the one that will receive some or all of the goods or services under the contract. For example, assume a credit card company has a contract with a merchant. The merchant pays the credit card company an interchange fee for receiving the credit card services. The credit card company also has a separate contract with the credit card holder to extend credit and provide a rewards program under which the holder accumulates points each time he or she uses the credit card. The accumulated points can be used to redeem goods or services or receive cash rebates from the credit card company.

Should the rewards program with the credit card holder be accounted for as part of the credit card company's contract with the merchant because the rewards points are accumulated based on the volume of the card holder's transactions with the merchant and the only payments the credit card company may receive are the interchange fees from the merchant (assuming credit card customers do not pay an annual fee and/or incur finance charges)? Additional clarity on applying the proposal to arrangements involving multiple parties affected by a contract would help avoid diversity in practice.

Approval of a contract

Paragraph 14(b) states that the proposal would apply only if the parties to the contract have approved the contract in writing, orally or in accordance with other customary business practices. We believe this requirement for approval is not clear and would result in a significant change in practice in some situations if read literally. That is, do the Boards intend for the customary business practice to strongly influence the determination of whether approval has been obtained? If so, when would an entity whose customary business practice is obtaining written approval be able to determine that a contract exists based on oral approval, if ever? Based on questions we have received, the notion of "customary business practice" may be overlooked because it is one of three approaches to determining whether

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approval has occurred. We suggest deleting the references to approval in writing, orally or in accordance with other customary business practices in paragraph 14(b) because paragraph 13 already clarifies that enforceable rights and obligations are required and states that contracts can be written, oral or implied by an entity's customary business practices.

Paragraph 14(b) also states that the proposal would apply only if the parties to the contract are committed to perform their respective obligations. We recommend the Boards provide additional guidance on how an entity (buyer or seller) can demonstrate a commitment to perform. The need for this additional guidance is particularly important for some transactions (e.g., sales of real estate) because the recognition of revenue (or a gain) when a customer has not made a down payment would represent a significant change in practice from current US GAAP. For example, in an arrangement in which the seller finances the transaction and the customer is not required to provide a down payment or the customer makes a down payment but the financing is nonrecourse, it is unclear how the customer would demonstrate a commitment to perform.

Contract modifications

We believe certain aspects of the contract modifications guidance require clarification. For example, if a contract modification is determined not to be a separate contract and the remaining goods or services are distinct from the goods or services transferred on or before the modification date, it is not clear how an entity would account for variable consideration. That is, before the contract modification, changes in variable consideration would be allocated to satisfied and unsatisfied performance obligations (in accordance with paragraphs 77-80). However, once the modification occurs, it appears from paragraphs 22(a) and (c) that future changes in variable consideration would be allocated only to performance obligations that were not satisfied at the modification date. This appears to be the case even if the variable consideration originally was determined to relate to all performance obligations, including those that are fully satisfied at the modification date. We believe it would be helpful to provide an example of the application of paragraphs 22(a) and (c) to arrangements that contain variable consideration.

We also believe paragraphs 22(a) and (c) should be amended to clarify the accounting for contract assets at the date of a contract modification. The proposal currently would require the allocation of the modified transaction price to include the amount of consideration received from the customer but not yet recognized as revenue (e.g., a contract liability) plus the amount of any remaining consideration that the customer has promised to pay. The modified transaction price would not appear to include consideration that an entity already has a right to receive (e.g., a contract asset), which seems inconsistent with including the contract liability (if any) in the allocation of the modified transaction price.

Identifying separate performance obligations

Identifying performance obligations is a critical component of the proposal. We believe more guidance is needed to help entities identify distinct goods or services and separate performance obligations. Therefore, we request that the Boards provide implementation

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guidance for common types of arrangements within certain industries to promote consistency in practice.

For instance, below we describe several arrangements that are common in the real estate industry that we do not believe are clearly addressed by the ED. The questions these examples raise are not unique to real estate, and we frequently receive similar questions from other industries.

First, amenities are frequently sold or transferred in connection with the sale of individual units of a real estate project. For example, a developer may commit to construct a clubhouse that will be transferred to the homeowners' association in a condominium development once 50% of the 100 condominiums in the development are sold. If the right to access the clubhouse is considered part of the contract with a customer for the sale of an individual unit, would the clubhouse be considered a distinct good, and thus a separate performance obligation under the contract or would the clubhouse not be considered distinct and therefore be combined with the sale of the individual condominium in a single performance obligation? If the clubhouse is distinct, it is unclear what proportion of the transaction price should be allocated to the clubhouse (e.g., based on $1/100^{th}$ of the clubhouse assuming a proportionate amount is allocated to each condominium expected to be sold, $1/50^{th}$ of the clubhouse based on the minimum number of condominiums that must be sold to trigger transfer of the clubhouse, or some other amount). This conclusion also would affect whether the performance obligation to deliver the amenity is onerous.

Second, time-shares are often sold in intervals (a specific unit for a specific week during the year) or in the form of points that a customer can redeem for occupancy at various sites. Under current practice in US GAAP, revenue is recognized up front when certain criteria in ASC 360 and ASC 978 are met. When the project is still under construction, the percentage of completion model in ASC 360 is used. It is unclear how the proposal would affect time-share accounting. Specifically, we have received several questions about whether a distinct good or service (and separate performance obligation) would be a specific time-sharing unit, an allotment of points in the contract that the customer is able to use, sell or exchange or the customer's right to use the time-share each year. Depending on the conclusion, the pattern of transfer (that is, whether the goods and services are delivered at a point in time or over time) and the timing of revenue recognition could be different from current practice.

Last, in arrangements in which land is sold with a future commitment to develop the land (for example, by constructing a building), we believe the land and future building would likely both meet the criteria to be "distinct" (paragraph 28). In our view, the land and future commitment to develop it generally would not meet the requirements of paragraph 29 to be accounted for as a single performance obligation. That is, the land and the future commitment to develop it are not highly interrelated because, even without the future development, the land would retain its value and could be sold to another party. We have not identified circumstances to suggest that entities should reach different conclusions on this issue, and we suggest the Boards include an example of this fact pattern in the final standard.

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We also believe additional clarification is required to apply the practical expedient in paragraph 30 that would allow entities to account for two or more distinct goods or services as a single performance obligation if those goods or services have the same pattern of transfer. The example in this paragraph illustrates two services being transferred over the same period of time. We understand that the "same pattern of transfer" is not intended to be limited to transfers that occur over the same period of time (i.e., if an entity determines that the patterns of transfer for two services were both based on labor hours, the entity could combine them), but this is not clear in the proposed guidance. In addition, for this practical expedient to be appropriate, we believe the Boards should clarify that a different pattern of revenue recognition should not result from combining two or more distinct goods or services under this paragraph.

In addition, the example illustrates *services* with similar patterns of transfer, but it is unclear how the practical expedient would affect the accounting for a series of *goods* to be delivered under a contract with a customer. For example, an entity would likely determine that each of 10 aircraft promised in an arrangement represents a distinct performance obligation (paragraph 28), but the entity could also elect to treat the 10 aircraft as a single performance obligation because the aircraft have a similar pattern of transfer (paragraph 30). By accounting for all 10 aircraft as a single performance obligation, the costs incurred to construct the first several aircraft (which might include learning costs) would be deferred and amortized on a systematic basis consistent with the pattern of transfer of goods and services. However, it is unclear from the guidance in paragraph 98 whether the amortization would be based on specific identification (that is, more costs, and therefore lower margins, are recognized upon delivery of the first few aircraft) or if cost averaging could be applied. We request that the Boards clarify the application of this guidance to a series of goods by providing an example.

As a final comment, we do not understand how to apply paragraph 28(b) to contracts involving goods or services that are not sold separately by the entity and cannot be used without additional goods or services that are provided only by that entity. For example, a restaurant franchisor may license the use of its trade name and other related intellectual property to a franchisee, but the intellectual property does not have value (the restaurant cannot operate) without the patented restaurant equipment that has to be purchased from the franchisor.

Paragraph 28(b) states that a good or service is distinct if a customer can benefit from the good or service together with other resources that are readily available to the customer, including goods or services that are sold separately by the entity. In the restaurant franchise example, the intellectual property would be considered distinct if the equipment is sold separately by the entity. It is not clear why this result is appropriate when the intellectual property can be used only with equipment that is solely provided by the entity. That is, why should the intellectual property be accounted for separately from the equipment when the purchase of the equipment is necessary to receive value from the intellectual property? We recommend that the Boards consider the application of paragraph 28(b) to this and similar situations and provide additional guidance, perhaps through additional clarification in Example 26.

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Measuring progress toward complete satisfaction of a performance obligation

We believe the proposed guidance in paragraphs 38-48 should be clarified.

Paragraph 40 states that output and input methods can be used to measure progress toward complete satisfaction of a performance obligation. The proposal would require the use of a consistent method for similar performance obligations and in similar circumstances. The Boards have not clearly stated whether the selection of a method is an accounting policy decision, and this should be clarified. Assuming that the method of measuring progress toward satisfaction is an accounting policy decision and neither an input nor output method is preferable, is it the Boards' intention that an entity would not be allowed to change from its selected approach? Additional clarification of the Boards' views would be helpful.

In addition, this guidance indicates that an entity has to select one method for measuring progress. It is not clear how an entity would decide which method to use for a performance obligation that consists of multiple goods and services that were combined because they either (1) were not distinct (in accordance with paragraph 27) or (2) met the criteria for a bundle of goods and services (in accordance with paragraph 29) when the pattern of transfer of the goods and services is not consistent. To illustrate, assume a contract includes both design and construction services. The best method to determine the pattern of transfer of control for the design service is engineer labor hours, but the best method to determine the pattern of transfer for the build/construction service is a cost-to-cost method. Paragraph 47 seems to indicate that if an entity is unable to select one method, revenue would not be recognized until the contract is complete. It would be helpful for the Boards to provide additional guidance on measuring progress for these types of arrangements.

Paragraph 42 indicates that an entity would recognize revenue in the amount to which the entity has a right to invoice if that amount corresponds directly with the value to the customer of the entity's performance completed to date. We believe this guidance would be helpful to many entities when applying the five-step model. However, as currently written, we believe the guidance could be inappropriately applied. For example, some entities may believe it is appropriate to apply this concept to billing milestones that are linked to incremental deliveries occurring within a single performance obligation (that is, upon delivery of the first and fifth items). We request that the Boards clarify the application of this guidance to goods by providing an example that includes milestone billings.

Paragraph 46 provides guidance on using an input method to measure progress when the customer obtains control of certain goods significantly before receiving the services related to those goods. The guidance says the best depiction "may be" to recognize revenue equal to costs incurred. This seems to imply that there is more than one acceptable method. Is this the Boards' intent? Also, we believe paragraph 46(b) should be worded as follows: "The entity procures the goods from another entity and is not significantly involved in designing and/or manufacturing the goods…" Without this edit, an entity that is significantly involved in the design of a good but contracts with another entity for manufacturing would not apply the requirements of this paragraph to the uninstalled materials.

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Paragraph 48 would permit an entity to recognize revenue for costs incurred when the entity is not able to reasonably measure the outcome of a performance obligation that is satisfied over time. However, when performance obligations satisfied over time include variable consideration, it is unclear how the revenue recognition constraint described in paragraphs 81-85 would interact with the guidance in paragraph 48. Would it be appropriate for an entity to recognize variable consideration to the extent of costs incurred even when those amounts may not be reasonably assured? That is, does the recognition constraint of "reasonably assured" only relate to the recognition of profit? We think it would be helpful for the Boards to clarify this point.

<u>Measurement of revenue – variable consideration</u>

It is unclear how the guidance in paragraph 55 would be applied to the estimation of variable consideration when none of the possible amounts of consideration individually has a likelihood of occurrence greater than 50%. For example, assume a contract with the following possible outcomes:

Likelihood	Outcome
10%	$ 100
30%	$ 60
20%	$ 40
40%	$ 0

While we believe that an expected value method should be used to estimate the transaction price because there is not a single amount that is more than 50% likely to occur, paragraph 55(b) states that the most likely amount "is the single most likely amount in a *range* of possible consideration amounts." This seems to indicate that estimating the transaction price based on the most likely amount of consideration could be appropriate in this example even if no individual outcome is more than 50% likely to occur as long as that method better predicts the amount of consideration to which the entity will be entitled.

In addition, it is not clear whether the most likely amount in this example would be the individual outcome that is more likely to occur than any other outcome (i.e., $0) or the maximum amount that is more likely than not to occur (i.e., $40 because the entity has a 60% probability to receive at least $40). We believe it would be helpful for the Boards to clarify this guidance.

<u>Measurement of revenue – time value of money</u>

We agree that adjusting the promised amount of consideration in a contract to reflect the time value of money is appropriate when a contract contains a significant financing component. We also support providing a practical expedient if the period between the satisfaction of the performance obligation and payment of consideration from the customer is one year or less. However, we observe that in many jurisdictions with high interest rates, a significant financing component may be present even when the period between the satisfaction of the performance obligation and payment of consideration from the customer is one year or less. We believe the Boards should highlight this possibility and provide that

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the practical expedient should not be used if the implicit financing rate is so high that the financing component is clearly significant.

In addition, we are concerned that the proposed guidance, as currently written, lacks clarity in certain regards and, as a result, will not be applied consistently in practice. In response, we offer several suggestions below that we believe would improve the proposal.

The last sentence of paragraph 58 suggests that a two-step process should be followed for each contract with a customer. First, an entity would compare the cash selling price for the goods or services to the promised amount of consideration. If there is a difference, the entity would determine whether the financing component is significant in accordance with paragraph 59. Is a two-step process what the Boards intended? For example, it appears that if there is no difference between the cash selling price and the promised consideration, there would not be a significant financing component in the contract even if the payment terms are greater than one year. If this was not the Boards' intent, we believe it would be helpful to delete the last sentence of paragraph 58.

In addition, it is unclear how an entity would apply the guidance in paragraph 58 to situations in which revenue is not reasonably assured. For example, assume an entity will receive a 10-year sales-based royalty on its licensed intellectual property. The entity would be precluded from recognizing revenue until the amounts are reasonably assured (that is, until future sales occur). However, in accordance with paragraph 58, an entity would need to recognize interest to reflect the time value of money. In this type of situation, is it the Boards' intent that an entity identify a time value component in the future royalty stream payments? It would be helpful for the Boards to clarify this point.

Further, we believe the guidance in paragraph 59(b) (suggesting that the typical credit terms in the industry and jurisdiction be considered when evaluating whether a financing component is significant to a contract) could be interpreted to permit arrangements with significant up-front payments to be excluded even when the satisfaction of the performance obligation will occur over several years. For example, an entity could conclude based on paragraph 59(b) that a contract to construct and deliver an aircraft carrier in five years with a 20% down payment required at contract inception does not include a significant financing component because the 20% down payment is customary in the industry. This outcome is not consistent with our understanding of the Boards' intent, and we recommend the references to typical credit terms be deleted.

We believe the Boards should clarify how to apply the practical expedient in paragraph 60 when there is more than one performance obligation in the contract. Some performance obligations in a contract may be satisfied more than one year before or after the consideration is received, while other performance obligations in the contract will be satisfied in less than one year from receipt of consideration. In these situations, is the consideration for time value of money required only for performance obligations satisfied one year or more before or after receipt of the consideration? Or should the effects be considered for the contract as a whole?

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We also suggest that paragraphs 60 and 61 be clarified to indicate whether the assessment of the time value of money should occur only at contract inception (as suggested by paragraphs 60 and 61) or also in subsequent reporting periods (e.g., when the estimated transaction price is updated for variable consideration or a contract modification occurs).

Measurement of revenue – noncash consideration

We do not believe the accounting for share-based payments received by an entity as consideration from a customer has been adequately addressed in the proposed model. Paragraph 63 would require noncash consideration (such as share-based payments) to be measured at fair value, unless the fair value cannot be reasonably estimated. However, the Boards have not provided any guidance to determine when and how the fair value of share-based payments from customers should be measured.

For example, assume on 1 January an entity agrees to transfer three products to a customer for $10,000. The entity can earn 100 options to purchase the customer's shares for either $10 per share if the three products are delivered by 1 May or $5 per share if the three products are delivered by 1 April. The company estimates it will deliver the first product on 1 March, the second product on 1 April and the third product on 1 May.

First, it is not clear how the entity should measure the fair value of the noncash consideration in accordance with paragraph 63. That is, should the likelihood of meeting the 1 April and 1 May delivery dates be incorporated into the estimated fair value of the share-based payments? This would not be consistent with the existing guidance for share-based payments under US GAAP and IFRS that excludes performance conditions from the measurement of fair value.

Second, should the fair value of the share-based payments be estimated only at contract inception (1 January), or should changes in the fair value of the share-based payments based on the outcome of the performance condition be reflected in the revenue recognized by the entity? That is, should the changes in the fair value of the options since contract inception be recognized as revenue when the products are delivered to the customer?

We believe changes in the fair value of share-based payments received from a customer should be incorporated into the estimated transaction price, but we do not think the current proposal provides sufficient guidance. Applying the proposed model for variable consideration (i.e., determining an amount based on expected value or most likely amount) actually conflicts with the requirement to determine the "fair value" of noncash consideration in paragraph 63 of the ED. That is, neither expected value nor most likely amount is considered a fair value measurement.

Further, while current US GAAP related to grantee accounting for nonemployee equity-based awards (proposed to be deleted by the consequential amendments) contains explicit guidance for *when* a share-based payment should be measured, paragraph 63 of the ED is silent on this point. IFRS does not currently provide specific guidance on this issue. We note that IFRS 13 provides a framework for measuring fair value but it does not specify the measurement date for the underlying transaction.

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Our observation about the lack of clarity around the measurement date is also relevant with respect to other types of noncash consideration. For example, it is unclear whether the fair value measurement of a piece of equipment transferred by the customer to the entity as noncash consideration would be measured at contract inception, at the date the performance obligation is satisfied or at the date control of the equipment is obtained from the customer (and recognized in the financial statements). Further, if the measurement of fair value occurs before the equipment is recognized in the financial statements, would the equipment be remeasured upon acquisition or is the original fair value determined for revenue recognition purposes deemed to be the original cost for the purposes of applying ASC 360 and IAS 16?

We believe the noncash consideration section needs to be revised to address these issues. Otherwise, given the complexities in this area, which led to the detailed existing guidance for share-based payments in US GAAP, significant diversity may arise in practice.

As a separate comment, paragraphs 63 and 64 do not appear to explicitly prohibit revenue recognition for nonsubstantive performance obligations that would likely involve noncash consideration (e.g., round-tripping). We believe specific guidance is needed for these types of arrangements. Specifically, we believe the guidance for noncash consideration should explicitly state that the transfer of goods and services in exchange for noncash consideration should be substantive and provide guidance on *how* to assess whether a revenue transaction is substantive (similar to the current guidance in ASC 605-20-25-14 through 25-17 on advertising barter transactions and SIC-31, *Revenue-Barter Transactions Involving Advertising Services)*. We do not believe the current guidance in paragraphs 9 and 14 is sufficient, and we request that the Boards clarify the model to explicitly prohibit revenue recognition for these types of arrangements.

[IASB comment only] In addition, to support convergence and ensure consistent interpretation of the requirements in paragraph 63, we encourage the Boards to clarify how they would interpret a "reasonable estimate of the fair value." While this terminology is used in current US GAAP, it is not used in IFRS. Instead, IFRS typically refers to reliable estimates of fair value, for example, in paragraph 5 of SIC-31. It is not clear whether the Boards envisage a reasonable estimate of fair value and a reliable estimate of fair value to be different thresholds or synonymous. In addition, should the term "reasonable estimate" be given the same meaning as that applied in current practice under US GAAP? Without further clarification, we believe there is a risk of divergent practice.

<u>Measurement of revenue – consideration payable to a customer</u>

If the consideration payable to a customer is a payment for a distinct good or service, it is not clear from paragraphs 66 and 67 whether the fair value of the goods or services received from the customer would be measured at contract inception or at the time the goods or services are received. Also, it is not clear whether "negative" revenue from a customer (that is, sales incentives, discounts and rebates given to a customer in the form of cash, credits applied against customer payments or equity instruments that *exceed* the transaction price) would be presented as an expense, consistent with current US GAAP. IFRS does not currently provide specific guidance on the presentation of "negative" revenue. Due

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to the current divergence in accounting treatment between US GAAP and IFRS, it would be helpful for the Boards to clarify these points.

Also, the conclusion on slotting fees is not clear in the proposed model. As we previously stated in our comment letter on the ED issued in June 2010, we do not believe slotting fees that involve specific placement of goods owned by the customer for which the entity has already recognized revenue represent a distinct good or service. We think it would be helpful for the Boards to clarify whether slotting fees might represent a distinct good or service and, if so, in what circumstances.

Last, the interaction between the variable consideration guidance and the guidance on consideration payable to a customer should be clarified. For example, in many situations there would not be a significant distinction between an arrangement containing an incentive that should be accounted for in accordance with the variable consideration guidance in paragraph 53 and an arrangement in which the incentive is consideration payable to a customer. However, since variable consideration is required to be estimated at the inception of a contract, but consideration payable to a customer might not be recognized as a reduction of revenue until a later point (in accordance with paragraph 67), it is important that the guidance distinguish between these two. This point is illustrated in Example 10 in the proposed guidance. That is, it is not clear from Example 10 why the entity recognized revenue at $100 per unit for the period ended March 31 rather than $90 per unit in accordance with paragraph 67(a) because any amounts in excess of $90 per unit are variable consideration that is not expected to be received. We believe a more straightforward example would be to illustrate the accounting for an existing contract when a new discount program is introduced that affects satisfied and partially satisfied performance obligations.

Allocating the transaction price

We support the proposed approach to allocating the transaction price to separate performance obligations in an amount that depicts the amount of consideration to which an entity expects to be entitled in exchange for satisfying each performance obligation. However, we have a number of observations regarding the application of this principle and believe the Boards should provide additional guidance.

Determining standalone selling price

Paragraphs 71-73 provide guidance on allocating the transaction price based on the estimated standalone selling price of the goods or services. However, it is unclear how this guidance would be applied to long-term supply arrangements in which the contract price for the series of goods decreases (or increases) over the term of the arrangement. That is, it is unclear whether (a) the stated contract price should be used to recognize revenue as each good is delivered (assuming it reflects the standalone selling price of the good at the time control is transferred) or (b) the entity should recognize revenue using the average price over the term of the arrangement. We think the Boards should clarify this aspect of the proposal with an example.

Similarly, it is unclear whether the standalone selling price for a commodity that will be transferred at a future date should be determined based on the selling price of the

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commodity at contract inception (the spot price for immediate delivery) or the selling price of the commodity on the date that control will transfer (the forward price for delivery at the forward date). We believe additional guidance would be helpful.

It would also be helpful for the Boards to clarify that when determining the standalone selling price for each good or service, an entity can take into consideration the fact that the goods or services may never be claimed (breakage). For example, under the "expected cost plus a margin" approach, we believe it would be appropriate for an entity to consider the effect of breakage because unclaimed goods or services will not ultimately result in a cost to the entity. There is some uncertainty in practice about this issue. A cross-reference to paragraphs IG25-IG28/B25-B28 (customers' unexercised rights) might be sufficient.

Even though paragraph 73(b) seems to indicate that an entity can rely solely on an expected cost plus a margin approach, it seems that an entity would also have to consider the adjusted market approach in coming up with its estimate of a standalone selling price in order to maximize the use of observable inputs. That is, an entity could not determine that the expected cost plus a margin approach represents a reasonable standalone selling price if the market would not support the amount of margin required by the entity. Based on questions we are receiving, we believe this point may be overlooked by preparers. We think it would be helpful for the Boards to clarify that point.

We believe that the proposed guidance in paragraph 73(c) limiting the use of the residual method only to situations when the standalone selling price is highly variable or uncertain may be too narrow. We believe using a residual approach may be desirable compared with estimates of standalone selling price in certain situations, such as in circumstances when it would be more appropriate for the discount in an arrangement to be allocated to the first delivered item.

Allocating the discount or variable consideration

Paragraph 75 would require an entity to allocate a discount to one (or more) separate performance obligations if the entity regularly sells each good or service (or bundle of goods or services) on a standalone basis and the observable selling prices from those standalone sales provide evidence of the good or service to which the discount relates. It is not clear how the guidance would be applied when a bundle of goods or services are provided at a discount, but the discount for the bundled arrangement is different from the observable discount provided for some of the goods or services when those goods or services are sold separately. Refer to Example 1 below. We request that the Boards clarify this aspect of the model and/or provide an example to illustrate how this guidance would be applied.

Example 1
Golf Corp is a full-service golf shop that offers lessons and custom club making and sells retail equipment and apparel. It regularly sells private lessons on a standalone basis for $150 per one-hour session. However, when a customer purchases a new set of custom clubs (irons only), the company offers a one-hour lesson for half- price. The lesson is generally scheduled when the clubs are ready and delivered together. Golf Corp sells a custom irons package (with free lesson) along with a number of retail

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items to a customer and delivers all of the retail items on the date ordered. The customer arranges to pick up the irons and take her lesson one month later. The package price and standalone selling prices of each item are as follows:

Item	Standalone selling price	Price when bundled	Bundling discount
Lessons (per session)	$ 150	$ 975	$ 75
Custom irons	900		
Retail putter	125	125	–
Retail bag	175	175	–
Retail woods	650	650	–
	$ 2,000	$ 1,925	$ 75

Due to the timing of delivery, Golf Corp chooses to account for two performance obligations: all retail items and the custom irons/private lesson bundle. Because Golf Corp regularly sells the lessons and custom irons together for $975 and all other retail items at their standalone selling prices, the company has observable evidence that that the $75 discount inherent in the package is attributable to the custom irons/private lesson bundle. Golf Corp, therefore, allocates 100% of the discount to the custom irons/private lesson bundle, which is reflected in the following allocation:

	Allocated amounts
Custom irons/private lesson	$ 975
Retail clubs and bag	950
Total	**$ 1,925**

This example assumes the discount for the larger bundle of goods and services is exactly equal to the discount for a custom irons/private lesson bundle ($75). It is unclear how an entity would treat a discount of more than $75 for the larger bundle. For example, if the discount on the larger bundle totaled $125, it is unclear whether $75 would be allocated to the lessons and custom irons with the remainder allocated to the other three items or whether the entire $125 discount would be allocated to all of the performance obligations based on the relative standalone selling prices (i.e., the entity would not be able to use the exception to allocate a discount to only certain performance obligations).

Paragraph 76 states that a contingent amount of the transaction price would be allocated to a distinct good or service if certain criteria are met. As an overall comment, it is unclear why the Boards chose to refer to a "distinct good or service" in this paragraph rather than a "performance obligation." To be consistent with paragraph 75, we believe paragraph 76 should be revised to refer to a "performance obligation." We are also concerned that this guidance, as currently written, could be unclear when the goods and services are not distinct (in accordance with paragraph 27), when the goods and services are bundled (in accordance with paragraph 29) or when the goods and services are combined (in accordance with the practical expedient in paragraph 30).

We also believe this guidance would result in a significant change from current practice for many entities that generally allocate all consideration – whether fixed or variable – to the

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identified performance obligations. As a result of each of the following concerns identified with this concept, we request that the Boards clarify this aspect of the model and/or provide an example to illustrate how this guidance should be applied to similar fact patterns:

- It is not clear whether the requirement to allocate variable consideration to a single performance obligation could be applied if the variability in the total transaction price is attributable to more than one but not all of the performance obligations in the arrangement. Refer to Example 2 shown below.

Example 2
Biotech agrees to license certain intellectual property to Pharma and to provide Pharma with on-going research and development (R&D) efforts for the further development of that intellectual property. In exchange, Pharma agrees to pay Biotech an up-front fee of $20 million, a fee of $300,000 per year per full-time equivalent (FTE) of R&D provided by Biotech and milestone payments if certain development targets are met. Management has determined that the R&D services and the license represent separate performance obligations. Biotech determines that any milestone payments received should be attributable to the goods and services already provided to Pharma at the time they are received. That is, Biotech believes the receipt of the milestone payment relates specifically to the efforts already provided (e.g., the license and the completed R&D services). However, since the license and the completed R&D services are separate performance obligations within the arrangement, it is unclear whether the milestone payments can be allocated to both performance obligations because paragraph 76 seems to suggest that variable consideration can be allocated to a *single* performance obligation (and not multiple performance obligations within an arrangement). If the milestone payments cannot be allocated to the license and completed R&D services, the milestone payments would be allocated either to a single performance obligation or to all of the performance obligations (including the R&D services that have not been performed).

- It is not clear how an entity would account for fixed consideration in arrangements in which the variable consideration is allocated to a single performance obligation. That is, would the entity also allocate any of the fixed consideration to that performance obligation, or is the entity precluded from doing that because the entity determined the variable consideration relates to that particular performance obligation? Refer to Example 3 shown below.

Example 3
A manufacturer offers Products A, B and C for $60 plus a sales-based royalty related to the technology used in Product C. Products A and B are frequently sold separately for $35 each and Product C is frequently sold separately for $50. The manufacturer estimates the transaction price to be $125 for all three items, which includes $65 in royalties related to Product C.

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Based on the guidance in the ED, the manufacturer would allocate $30 each to Products A and B and the entire variable amount of $65 to Product C. Although the manufacturer expects to earn a premium on the contract as a whole due to the favorable terms of the royalty arrangement for Product C, none of the premium is allocated to Products A and B because the contingent amount relates specifically to the outcome of the performance obligation to transfer Product C. Further, the estimated value of the contingent consideration, while not equal to the estimated standalone selling price of Product C, is reasonable in relation to the standalone selling price of Product C. The manufacturer would recognize revenue of $30 each upon transfer of control of Products A and B. Product C also is transferred at a point in time, but the ED provides that the amount the entity is entitled to receive for royalty arrangements is not reasonably assured until the customer completes the subsequent sales. Therefore, the revenue related to the sales-based royalty would be recognized as the underlying sales related to the technology used in Product C occur.

- It is not clear for arrangements that include multiple variable payment streams whether it would be possible to determine that some of the variable payment streams are related to only certain performance obligations, but other variable payment streams are related to all of the goods and services in the arrangement.
- It is not clear how this requirement would interact with the guidance in the proposal on contract modifications. Refer to Example 4 shown below.

Example 4

Biotech agrees to license certain intellectual property to Pharma and to provide Pharma with on-going research and development (R&D) efforts for the further development of that intellectual property. In exchange, Pharma agrees to pay Biotech an up-front fee of $20 million, a fee of $300,000 per year per full-time equivalent (FTE) of R&D provided by Biotech and milestone payments if certain development targets are met. Management determines that the R&D services and the license represent separate performance obligations. Further, management allocates all of the milestone payments to the license because (1) the milestone payments relate specifically to Biotech's efforts to transfer the license and (2) the allocation depicts the amounts Biotech expects to be entitled for transferring its license to Pharma.

Biotech renegotiates the scope of the R&D activities and the amounts that Pharma will pay for those ongoing activities. The renegotiations do not result in a new, distinct performance obligation.

The proposed guidance for contract modifications would require the entity to allocate any changes in expected consideration as a result of the contract modification, and any future consideration yet to be received related to satisfied performance obligations, to the remaining performance obligations in the contract. In this example, a literal read of the proposal suggests that Biotech would be required to allocate all future amounts to which it is entitled (including milestone payments) to the R&D activities that have not yet been provided. However, it seems more appropriate to continue to allocate the amounts related to the milestone payments to that satisfied performance obligation (that is, the license).

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- It is not clear how an entity would demonstrate that criterion (b) – allocating the contingent amount of consideration entirely to the distinct good or service is consistent with the allocation principle - had been met. We believe that the Boards should consider removing this criterion.

Costs to fulfill a contract

Paragraph 91 proposes requirements for capitalizing costs to fulfill a contract. It is unclear from paragraph 91(b) how a company would determine whether costs "generate or enhance resources of the entity that will be used in satisfying performance obligations in the future." Does an asset need to be created for this criterion to be met? For example, it appears that costs incurred for data migration in a hosting arrangement would be directly related to the contract (as required by the criterion in paragraph 91(a)) and expected to be recovered (as required by the criterion in paragraph 91(c)), but these costs do not appear to create an asset. The Boards should clarify this point by providing an example.

Paragraph 93 provides the requirements for recognizing costs as expenses when incurred. It is unclear from paragraph 93(b) how entities would be able to identify whether the costs of a particular wasted material, labor or other resource were included in the original contract. For example, how would unexpected inefficiencies or, conversely, proficiencies in a production process be considered based on this proposed guidance? We believe that currently many entities simply include those costs in the initial and ongoing estimates to complete the contract as long as there is sufficient gross margin available to absorb them. We suggest that the wording be clarified to indicate that only significant abnormal costs should be expensed.

Amortization and impairment of costs to fulfill or obtain a contract

We have certain observations about paragraphs 98-103, which propose guidance on amortization and impairment of contract costs. First, we think the Boards should clarify whether the unit of account for the impairment of contract costs is at the contract-level or some higher-level.

Second, is there a specific threshold (e.g., probable) that should be considered when determining whether an "anticipated" contract should be included in the amortization period? Without further guidance, we anticipate that inconsistent application of this principle would occur as entities would likely evaluate it differently. We request that the Boards provide additional guidance on this aspect of the proposed model.

Third, we believe that the proposed treatment for contract costs is inconsistent with the current tentative decisions reached by the Boards in the Leases project. While we are supportive of the changes intended to make the capitalization of certain costs consistent across the revenue, leases and insurance projects, the amortization of those costs is not yet consistent among the proposed standards. Under the leasing proposal, initial direct costs would be amortized over the lease term (i.e., the noncancellable period plus any optional periods when there is a significant economic incentive to extend or not terminate the lease). Anticipation of a lease renewal or extension would not be considered in the determination of the lease term. A consistent approach under the revenue model would require the use of the

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contract period for amortization, without giving consideration to anticipated contracts. We believe the accounting treatment for similar costs should be consistent between projects (or, alternatively, we believe that the Boards should clarify the rationale for this difference).

Presentation

Paragraph 106 provides guidance on the presentation of the right to consideration in exchange for goods or services as either a contract asset or receivable. We think the Boards should clarify that a right to consideration includes cash or noncash consideration.

Also, paragraph 106(b) states that a receivable exists if nothing more than the passage of time is required before payment is due. However, Example 17 (paragraph IG74/IE16) is not consistent with this guidance because its states that a receivable exists due to the noncancellable nature of the contract. It is unclear why the right to invoice a customer before any performance has occurred would constitute a receivable as this is inconsistent with the definition provided in paragraph 106(b). That is, the entity must still perform in order to be entitled to the consideration.

Further, we think an inconsistency in the facts provided in Example 17 also needs to be addressed. The example currently states that "the contract requires a customer to pay the consideration of $1,000 in advance on January 31." However, the paragraph goes on to state that "the customer pays the consideration on March 1." If the customer was required to pay on January 31, why did the customer pay on March 1?

Effective date and transition

Paragraph 133(a)/C3(a) describes one of the practical expedients for retrospective application of the proposal. It would be helpful for the Boards to clarify the date of initial application (the beginning of the first fiscal year after the effective date) because, in the US, there is a concern that initial application would be viewed as the beginning of the first year in the five-year table of selected financial data required by the Securities and Exchange Commission (SEC).

Principal versus agent considerations

We understand that the principal versus agent considerations in paragraphs IG16-19/B16-B19 are intended to be consistent with the current guidance in ASC 605 and IAS 18. In current practice, we understand there is a presumption for gross presentation in situations when the facts don't clearly suggest gross or net presentation under IFRS, and we agree with that presumption.

However, the lack of indicators for gross presentation in paragraph 17 and the inclusion of specific indicators for net presentation in paragraph IG18/B18 appear to create a presumption for net presentation. This is not consistent with our understanding of the Boards' intent, and we believe this should be clarified in the final standard.

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Customer options for additional goods or services

It is unclear why the first sentence of paragraph IG21/B21 limits the guidance for customer options to contracts with multiple performance obligations. We believe a substantive option could exist even when there is only one performance obligation (other than the option) in the arrangement. The Boards should clarify this point. Also, it is unclear whether the concept of evaluating a customer option to determine whether a "material right" exists is the same as the concept of evaluating significant economic incentives for lease terms in the Boards' joint leases project. The "significant economic incentive" concept is also used in the guidance on repurchase agreements in IG38–IG50/B38-B50. If the concepts are the same, we request that the Boards clarify this point and provide consistent guidance in both proposed standards.

Repurchase agreements

It is not clear from the proposed guidance whether a contract for the sale of a nonfinancial asset contains a put option if the asset is financed on a nonrecourse basis. That is, if the acquired asset (e.g., real estate, equipment or commodities) could be put back to the seller in satisfaction of the note balance, does that arrangement essentially contain a put option? In addition, paragraph 9 states that lease contracts within the scope of ASC 840 and IAS 17 are not in the scope of the revenue proposal. Therefore, when the guidance in paragraphs IG40/B40 and IG43/B43 indicates that entities should account for the contract as a lease in accordance with ASC 840 and IAS 17, we believe it would be more appropriate to indicate that entities should apply ASC 840 and IAS 17 by analogy.

Bill-and-hold arrangements

Existing SEC staff bill-and-hold guidance requires that the buyer **must** (rather than "may") request the bill-and-hold arrangement. Conversely, IAS 18 presumes that the bill-and-hold arrangement was made at the customer's request but does not explicitly require that it must be. It appears that the proposed guidance in paragraph IG51/B51 is modifying the current SEC requirements. We recommend the Boards modify IG51/B51 to state that the buyer **must** request the bill-and-hold arrangement or explicitly state in the Basis for Conclusions that the requirement is not consistent with IFRS and existing SEC guidance.

Comments on specific illustrations not addressed elsewhere

Example 15 (paragraph IG72/IE14) is intended to illustrate the accounting for costs that give rise to an asset. However, item (c) simply states that the costs to design, migrate and test the data center should be considered for capitalization in accordance with paragraph 91 and any resulting asset would be amortized on a systematic basis over five years as the entity provides the services outsourced by the customer. We think it would be more helpful for the Boards to expand this example to illustrate *how* these costs would be accounted for in accordance with paragraph 91.

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Editorial comments

We suggest clarifying in paragraph 29 that the good or service included in the bundle of goods or services described in this paragraph is not "deemed to be distinct" (instead of stating that the goods or services are not distinct). This is important because if goods and services are "not distinct," we understand paragraph 27 (rather than paragraph 29) would apply. Said another way, even if the goods and services meet the criteria for "distinct" in paragraph 28, an entity must look to the guidance in paragraph 29 to determine whether the goods and services should be bundled with other performance obligations in the arrangement (and therefore are not "deemed to be distinct").

Paragraph 37 provides indicators of when the transfer of control of a good or service occurs for performance obligations satisfied at a point in time. We suggest that these indicators be included in paragraph 32 as part of the general definition of control and referenced in paragraphs 35 and 37 because it seems that these indicators relate to transfer of control both at a point in time and over time. In addition, in order to emphasize that the timing of cash receipts in indicator 37(a) does not, by itself, affect revenue recognition, we think it is important to clarify that the cash receipts should relate to performance completed to date.

Paragraph 86 provides guidance on the scope of the onerous test and specifically refers to performance obligations satisfied over time. However, paragraphs 87-89 do not make this distinction. That is, they simply refer to performance obligations in general. We think it would be helpful to specifically refer to performance obligations satisfied over time in paragraphs 87-89 so that it would be clear to readers that the guidance in these paragraphs should not be applied to performance obligations satisfied at a point in time.

It is unclear whether the reference to derecognition of the liability for the onerous performance obligation in paragraph 88 is intended to imply that the guidance for extinguishing a liability should be applied (that is, US GAAP ASC 405-20-40-1, paragraphs 53-62 of IAS 37 and Conceptual Framework 4.15-4.19). The proposal provides guidance for determining when a performance obligation has been satisfied. Therefore, we believe it would be more appropriate to say "when an entity satisfies an onerous performance obligation, the entity shall remeasure the related liability."

In paragraph IG7/B7 for sales with a right of return, it doesn't appear that the sentence about updating the measurement of the asset to correspond to changes in the measurement of the refund liability considers all circumstances for change. To elaborate, measurement changes relating to the asset (such as impairment) might arise that don't affect the refund liability.

Appendix C – Comments on the proposed consequential amendments to US GAAP

Question 1: Do you agree that the proposed amendments that codify the guidance in the proposed Update on revenue recognition have been codified correctly? If not, what alternative amendment(s) do you recommend and why?

We do not have any concerns over how the revenue ED is proposed to be codified.

Question 2: Do you agree that the proposed consequential amendments that would result from the proposals in the proposed Update on revenue recognition have been appropriately reflected? If not, what alternative amendment(s) do you recommend and why?

For the most part, we believe that the proposed consequential amendments have been appropriately reflected. However, we are concerned about certain proposed amendments, as described below.

Amendments that appear outside the scope of the deliberated project

The proposed consequential amendments affect more than 50 Topics and 140 Subtopics within the Codification, some of which appear to be beyond the scope of the revenue project. Specifically, the proposed changes to advertising costs, equity-based payments from nonemployees and a reseller's characterization of sales incentives are not intuitive given the scope of the revenue ED. Further, the Boards did not publicly debate these issues or ask for comments on them.

Accordingly, we are concerned about possible unintended consequences that might result from the changes to these aspects of the literature because of potentially insufficient input received by the Boards. Our concern is heightened by the relatively short comment period for the US GAAP consequential amendments, which falls during a very busy period for most preparers and auditors and leads us to believe that some constituents may not have adequately considered the proposed changes.

We suggest the Boards consider extended outreach related to the consequential amendments to minimize any unintended outcomes. In the meantime, we provide the following observations on the proposed amendments.

Advertising costs

The proposed consequential amendments would supersede the guidance that currently exists for direct-response advertising. That proposed change and the edits to paragraphs 340-10-05-1(b) and 720-35-05-2 appear to indicate that advertising costs, including all direct-response advertising costs, would be expensed as incurred. That is, it appears that advertising costs would be considered a cost of obtaining a contract and, therefore, would only be capitalizable under the proposal if they were considered incremental costs. We do not believe that advertising costs, even direct response advertising costs, would be considered incremental costs based on our understanding of the ED.

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Further, it also is unclear why changing the accounting for advertising costs would be a consequential amendment resulting from the ED. This appears to be beyond the scope of the revenue project and not a consequential amendment of that project.

Equity-based payments from nonemployees

The proposed consequential amendments indicate that the guidance in ASC 505-50 on the accounting and reporting of share-based payment transactions by the recipient (grantee) would be deleted.

We have a number of concerns about this aspect of the proposed amendments. First, if this guidance is deleted in its entirety, there would no longer be any accounting guidance for nonemployee grantees receiving share-based payments through means other than a contract with a customer (for example, through a lessor-lessee relationship) despite the complexities and unique aspects of these transactions.

Further, and more significantly, we do not believe the guidance in ASC 505-50 should be changed for the reasons outlined within Appendix B of this letter, including the need for specific accounting guidance about how and when grantees should measure share-based payments. Finally, since the guidance in Subtopic 505-50 is not being deleted for transactions in which the vendor grants share-based payments to customers (for example, consideration payable to the customer as a reward for volume purchases), the accounting for share-based payments between vendors and customers would not be consistent.

Reseller's characterization of sales incentives

The current guidance on a reseller's characterization (presentation) of sales incentives offered to customers by manufacturers included in paragraphs 605-50-45-16 through 45-22 is listed to be superseded as part of the consequential amendments. In accordance with the specific guidance in these paragraphs and consistent with current practice, the reseller would recognize incentives from the manufacturer as revenue rather than a reduction of cost of sales. In other words, the reseller is exempt from specific guidance in Subtopic 605-50 (formerly EITF 02-16) that requires payments received from a vendor to be treated as a reduction of the purchase price of the goods or services received from the vendor unless the consideration from a vendor is in exchange for a distinct good or service. Deleting this guidance likely would represent a change in practice for resellers. We encourage the Boards to do more outreach to understand the effects of that decision.

This amendment also would change the accounting by the customer (i.e., the reseller) and, therefore, is beyond what we understand to be the scope of the ED, which addresses the accounting by the vendor.

Consideration received from a vendor

The proposed consequential amendments would remove the guidance currently found in 605-50-45-13(b) and 605-50-45-15. Under that guidance, cash received from a vendor that represents a reimbursement of a cost incurred by the customer to sell the vendor's products

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(for example, cooperative advertising) is characterized as a reduction of those selling costs when recognized in the customer's income statement.

Under the guidance proposed in 705-20-25-1 and 25-2, it appears the retailer would be required to account for this type of consideration as either a reduction of costs of goods sold, or as revenue (if the cash received is for a distinct good or service, regardless of whether the distinct good or service is an output of an entity's ordinary activities). Again, this change seems to be beyond a consequential amendment relating to the revenue ED because the ED proposes the accounting for the seller and this amendment would change the accounting by the customer.

Further, the proposed consequential amendments in paragraphs 705-20-25-1 through 25-3 do not appear to address the timing of recognition for consideration received from a vendor. While the guidance in 605-50-25-12 has been carried forward in proposed paragraph 705-20-25-3, the current guidance in 605-50-25-10 through 25-11 has not been carried forward. As a result, guidance on the timing of the recognition of consideration received from a vendor would no longer exist. We believe that the guidance in 605-50-25-10 through 25-11 should be carried forward in order for the guidance on vendor consideration to be complete, and therefore consistently applied.

Amendments that may require additional implementation guidance

We have concerns that certain proposed amendments will raise questions on the accounting for certain transactions. That is, for situations where existing literature provides specific guidance and the consequential amendments propose to delete that guidance, we do not believe the accounting will always be clear. As a result, we are concerned that without additional guidance in the proposal or implementation guidance on these topics, differences in practice may arise. As we discussed in our cover letter, we believe the Boards have an important role to play in promoting consistent interpretation and application in practice.

Repurchase agreements

The guidance in ASC 605-15-25-5 clarifies that an entity may recognize revenue upon the sale of a product to a dealer even if there is a possibility that the ultimate customer will lease the product from the entity, as long as certain criteria are met.

We would consider this transaction to be similar to an arrangement including a repurchase agreement. That is, in the event that the dealer finds a qualified buyer who wishes to lease the product from the entity, the entity will have to repurchase that product from the dealer in order to be able to lease it to the end buyer. Said another way, the dealer has a right to put the product back to the entity so that the end buyer can obtain a lease from the entity. While paragraphs 605-10-55-48 through 55-53 provide guidance on the accounting for repurchase agreements (including put options), we understand affected constituents appear to have different views on whether that guidance applies in this fact pattern. Specifically, some entities believe control has transferred when a car is sold to the dealer regardless of whether the manufacturer may subsequently enter into a lease arrangement with an end buyer. Without additional guidance, we anticipate that diversity in practice will result.

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Barter advertising transactions

Paragraphs 605-20-25-14 through 25-18 provide specific guidance on the recognition and presentation of the revenue and expense associated with barter advertising transactions. Specifically, this guidance establishes a requirement that an entity have a historical practice of receiving cash, marketable securities or other consideration readily convertible to cash as payment for advertising before the entity can recognize the revenue and expense arising from advertising barter transactions. This guidance was originally created to address transactions that were perceived as "round tripping" or lacking substance.

Because these paragraphs will be superseded and similar guidance is not currently included in the ED, we are concerned that an opportunity for entities to overstate revenue by recognizing revenue and associated costs on barter advertising transactions may again exist. We do not believe paragraph 14(a) in the ED, which would require that a contract have commercial substance, provides sufficient guidance to result in consistent and appropriate conclusions. Therefore, we believe additional guidance should be included to address these transactions, or these paragraphs should be retained in the Codification, perhaps as an example of how commercial substance can be assessed in a specific transaction.

Principal versus agent considerations

The guidance on principal agent considerations has been marked for deletion in its entirety, including the implementation guidance in Section 605-45-55. We have found that the determination of gross versus net reporting requires significant judgment and is an area where questions frequently arise in practice. To date, we have found the examples in the current implementation guidance to be helpful in making these determinations and are concerned that deleting them could result in confusion and inconsistent application of the guidance to similar facts and circumstances.

Real estate transactions

Time-share activities

The consequential amendments propose to remove the guidance now found in ASC 360-20, *Property Plant and Equipment – Real Estate Sales* and ASC 978-605, *Real Estate – Time-Sharing Activities – Revenue Recognition*. Under the current guidance in ASC 360-20-15-3, sales of real estate time-sharing interests are accounted for as sales of real estate using the "other than retail land sales" model. ASC 978-605 provides further guidance and illustrates the application of ASC 360-20 to the specific terms typically encountered in the accounting for time-sharing transactions.

Under the proposed amendments, only the general guidance in the revenue ED indicating that revenue would be recognized when or as a performance obligation is satisfied would exist. However, time-sharing transactions typically contain features unique to that industry (such as continuing involvement with real estate transferred to the buyer), and it is unclear how those features should be treated under the proposal. Specifically, it would be helpful for the FASB to provide guidance about the nature of the performance obligations in a time-share transaction.

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Partial sales of real estate

Under the current guidance in ASC 970-323-40-1, a sale of an investment in a real estate venture is the equivalent of a sale of an interest in the underlying real estate and is evaluated under the guidance in ASC 360-20. That is, a partial sale of real estate falls under the specialized real estate sales guidance and not under the deconsolidation and derecognition guidance in ASC 810. Under the proposed amendments, these types of arrangements would be subject to proposed Subtopic 605-40. However, it is not clear to us how one would treat a partial sale of real estate in accordance with proposed 605-40. We believe specific implementation guidance should be provided for partial sales of real estate.

Under the proposed amendments in ASC 360-10-40-3, nonfinancial assets that do not constitute a business are derecognized under the guidance in ASC 605-40. ASC 605-40-15-3 clarifies that nonfinancial assets that are a business are measured in accordance with Subtopic 810-10, unless it is a sale of *in substance* real estate, which then remains subject to the guidance in ASC 605-40. Under the guidance proposed in 605-40-15-3 and ASC 810-10-40-3A, it appears this exception applies only to *in substance* real estate and not to real estate held directly by an entity. The reason for this distinction is unclear.

Notwithstanding the above, we do not understand the conceptual basis for real estate businesses being scoped out of the guidance in ASC 810.

Scope clarifications

Rate-regulated and nonregulated entities

Paragraphs 980-605-25-17 through 25-18 are currently marked for deletion. It is our understanding, however, that the guidance in these paragraphs applies to both rate-regulated and nonregulated entities. Because rate-regulated entities are not in the scope of the ED, it may be appropriate to retain this guidance and clarify to which entities the guidance applies.

Health care entities

We believe that Topic 954 should be amended to explicitly state that revenue from prepaid health care service contracts should be recognized in accordance with 605-10. Otherwise health care entities may incorrectly apply the guidance in Topic 944 to these contracts. Specifically, in the absence of revenue scope clarification for prepaid health care service contracts, health care entities may incorrectly apply the guidance in Topic 944 for recognizing losses under these contracts as opposed to the onerous performance obligation guidance proposed in Subtopic 605-10 of the ED.

Oil and gas

Paragraphs 845-10-25-4 through 25-5 and 845-10-30-15 through 30-16 provide revenue-related guidance for entities in the scope of Topic 932, *Extractive Activities – Oil and Gas*. These paragraphs are not marked to be amended by the consequential amendments. Specifically, this guidance covers transactions that involve the purchases and sales of inventory with the same counterparty that may not necessarily be executed to facilitate

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sales to customers. Because the proposed scope paragraph of the ED (paragraph 9(e)) limits the scope exception only to transactions that facilitate sales to customers, it is unclear whether these transactions are within the scope of the ED. We believe this needs to be clarified.

Other

Last, it is unclear why transactions addressed by the guidance in Topic 323 and Topic 810 were not excluded from the scope of proposed 605-10.

Other suggested edits or questions on the consequential amendments

Consolidation of revenue disclosures

Given that the ED provides an overall disclosure objective and guidelines on appropriate disclosures, we believe that all required revenue disclosures should be contained within Topic 605. Therefore, we believe the FASB should remove all of the revenue disclosure requirements outside of Topic 605. The following are examples of disclosure requirements that currently reside in other sections of the codification that should be addressed as part of the consequential amendments:

- 932-235-50-24 – This paragraph requires specific disclosure of revenue for entities in the scope of Topic 932, *Extractive Activities – Oil and Gas*.
- 954-605-50-1 – This paragraph requires disclosure by health care entities of their methods of revenue recognition. This guidance should be deleted, or amended to only apply to contributions.
- 235-10-50-4(e) – This paragraph should be deleted or updated to refer to an entity's overall revenue recognition policy.

Clarify terminology

Within proposed paragraph 835-30-15-3(h), it is not clear what is meant by "other payments received pursuant to a contract with a customer." Would this include all payments received, or is this meant to capture something else?

Also, in places throughout the codification where examples of income statements are presented, it may be helpful to update those illustrations to reflect a separate line item for uncollectible accounts adjacent to revenue. Additionally, in places where the Codification refers to revenue, it is unclear whether that reference is to the amount before or after giving consideration to the effect of uncollectible accounts. For example, paragraph 280-10-50-30(a) contains a requirement to reconcile the total of the reportable segments' revenues to the consolidated revenues.

Technical corrections

It is not clear how the FASB will handle technical corrections that are currently proposed as part of the consequential amendments. For example, paragraph 954-430-25-1, which includes guidance for the recognition of advance fees received by continuing care retirement

communities (CCRCs), is currently under consideration for amendment in the proposed Technical Corrections Exposure Draft. If finalized as proposed, the amendment would clarify that a portion of the refundable advance fee would only qualify as deferred revenue (and subsequently be amortized over the life of the CCRC facility) if the contract between the CCRC and the resident explicitly stipulates that a portion of the advance fee is refundable only to the extent of the proceeds of reoccupancy of the contract holder's unit, and it is the entity's policy or past practice to comply with that limitation. If approved, this clarifying language will be a significant change for many CCRCs. As part of the proposals contained in the ED, paragraph 954-430-25-1 (including any revisions resulting from the Technical Correction project) would be superseded.

Suggested edits

Based on our review of the proposed consequential amendments, we suggest the following edits:

- Paragraphs 932-360-40-7 through 40-8 and 55-6 through 55-14 provide guidance on gain or loss recognition on the sale (or conveyance) of certain nonfinancial assets, but they are not currently marked for amendment. Since proposed paragraphs 360-10-40-3 and 605-40-15-3(a) indicate that only the sale of oil and mineral rights that constitute a business would be subject to this guidance, 932-360 should be amended to indicate this. Likewise, paragraph 932-360-55-2 requires that volumetric production payments be accounted for as unearned revenue to be recognized as oil or gas is delivered. Again, an amendment is necessary to clarify that this guidance applies only to the sale of oil and mineral rights that constitute a business.
- The first sentence of paragraph 310-10-35-11A pertaining to losses from uncollectible receivables states, "Generally, a loss from uncollectible receivables shall be charged to operations." We suggest amending the wording to read, "Generally, a loss from uncollectible receivables shall be charged to operations as a separate line item adjacent to the revenue line item."
- Paragraph 920-10-15-3 states, "The guidance in the Entertainment-Broadcasters Topic applies to all transactions and activities including…" Since revenue recognition will no longer be covered by the guidance in ASC 920, it does not seem appropriate to say this guidance applies to *all* transactions and activities.
- The terminology in paragraph 270-10-45-3 related to interim reporting revenue presentation matters needs to be updated to conform to that in the ED. The paragraph currently refers to percentage of completion contracts and also needs to be updated to reflect the onerous performance obligations terminology.
- Given the proposed change to accounting for advertising costs (i.e., elimination of ASC 340-20), the interim guidance in paragraph 270-10-45-9(d) related to presentation of costs and expenses doesn't seem appropriate.
- Paragraph 275-10-05-7 includes examples of estimates required as part of the financial reporting process. The second sentence states, "For example, accruing income for the

current period under a long-term contract requires an estimate of the total profit to be earned on the contract." To make this consistent with terminology in the ED, the FASB should consider changing the wording to, "For example, recognizing revenue on performance obligations satisfied over time requires an estimate of progress toward completion."

- Likewise, paragraph 275-10-50-11 pertaining to disclosures of significant estimates refers to "amounts reported under profitable long-term contracts." The FASB should consider changing the terminology to be consistent with ED.
- Paragraphs 740-10-25-25 and 55-78, related to temporary differences between tax and book accounting, should be updated because they currently refer to the percentage of completion method.
- It is not clear to us why paragraph 942-825-15-3, which addresses the scope of literature for certain financial guarantee contracts, is being included in the Depository and Lending industry topic section. Should this be in a broader category of guarantees, derivatives or financial instruments?
- We suggest providing within paragraph 360-10-40-3, which addresses the scope of literature for the derecognition of nonfinancial assets, the Codification reference for the accounting for the derecognition of nonfinancial assets that constitute a business or nonprofit activity (i.e., ASC 810-10), as was done in proposed paragraph 605-40-15-3.
- Paragraph 605-10-15-2(e) notes as a scope exclusion to the revenue topic "nonmonetary exchanges between entities in the same line of business to facilitate sales to customers, or to potential customers…" However, we note that paragraph 845-10-30-3 within the nonmonetary transaction guidance does not include the words "or to potential customers." It seems that the wording in these paragraphs should be consistent; therefore, one of these paragraphs needs to be edited.

Appendix D – Comments on the proposed consequential amendments to IFRS

Please note that the following are incremental comments on the proposed consequential amendments to IFRS. As such, we have not repeated comments included elsewhere in our comment letter.

Disposals of nonfinancial assets

Our overall comments on the proposed application of the ED's recognition and measurement requirements to the disposal of nonfinancial assets are included in our cover letter and response to question 6 in Appendix A. We have the following additional comments about the proposed consequential amendments to IFRS.

Application of the ED's recognition and measurement requirements to biological assets and agricultural produce

The ED's recognition and measurement requirements would apply to disposal of all property, plant and equipment within the scope of IAS 16 *Property, Plant and Equipment*, intangible assets within the scope of IAS 38 *Intangible Assets* and investment properties within the scope of IAS 40 *Investment Property*. It is not clear why an entity would not apply the same requirements to the sale of biological assets or agricultural produce within the scope of IAS 41 *Agriculture* if such assets are part of a disposal of a nonfinancial asset or a sale to a noncustomer.

Sales of biological assets and agricultural produce within the scope of IAS 41 are typically part of a contract with a customer and, therefore, would be within the scope of the ED. However, if, for example, an entity were to dispose of biological assets and/or agricultural produce as part of the sale of part of its operations (as contemplated in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*) it would generally be a disposal of a nonfinancial asset.

IAS 41 does not currently provide derecognition requirements. Therefore, it is unclear how an entity would determine when to derecognise the asset(s), or how to measure and recognise the consideration within a gain or loss on disposal when that disposal is not part of a contract with a customer.

We encourage the IASB to provide consequential amendments to IAS 41 to ensure consistency with those proposed in relation to IAS 16, IAS 38 and IAS 40 to address situations in which an entity disposes of a biological asset or agricultural produce and the contract for that disposal is not within the scope of the ED.

Constraint on recognition of consideration included within a gain or loss on disposal

The proposed consequential amendments in paragraphs D17 (paragraph 72 of IAS 16), D22 (paragraph 116 of IAS 38) and D26 (paragraph 70 of IAS 40) restrict the recognition of consideration included within the gain or loss on disposal to the amount to which the entity is reasonably assured. However, the ED itself only constrains the recognition of variable consideration in relation to contracts within its scope. We would encourage the IASB to amend the proposed consequential amendments to paragraphs D17, D22 and D26 to ensure consistency with the proposed constraint within the ED.

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Please refer to our cover letter and our response to question 6 in Appendix A for additional comments on the recognition of variable consideration in relation to the disposal of nonfinancial assets.

Editorial comment

The amendments to paragraphs D17 (paragraph 72 of IAS 16), D22 (paragraph 116 of IAS 38) and D26 (paragraph 70 of IAS 40) currently require an entity to recognise subsequent changes to the estimated amount of consideration that is reasonably assured as a gain or loss in the period in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. For the avoidance of doubt, we recommend identifying the specific requirements in IAS 8 that should be applied, that is, the requirements relating to changes in accounting estimates in paragraphs 32–40 of IAS 8.

Provisions, contingent liabilities and contingent assets

The proposed consequential amendment to paragraph 2(b) of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (in paragraph D21 of the ED) would exclude rights and obligations arising from contracts with customers within the scope of the ED, except as specified by the ED and other standards.

As a result of this amendment, other standards may require an entity to apply IAS 37 to a contract with a customer within the scope of the ED despite the exclusion from IAS 37's scope. For example, paragraph 31 of IAS 2 *Inventories* states: "Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess is based on general selling prices. Provisions may arise from firm sales contracts in excess of inventory quantities held or from firm purchase contracts. Such provisions are dealt with under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*." In light of paragraph 31 of IAS 2, a contract with a customer may be subject to the onerous contract test in IAS 37, potentially in addition to the onerous performance obligation test in the ED. This is illustrated in Example 5.

Example 5

Manufacturer A enters into a contract to design a widget for Customer B, to be completed within six months, and subsequently supply 100,000 widgets on a just-in-time basis over the next 18 months. The design services will be charged based on labour hours. The widgets will be charged at a fixed price per unit agreed upon at contract inception.

In accordance with paragraph 28 of the ED, the design service and the supply of each widget are considered by Manufacturer A to be separate performance obligations. However, Manufacturer A applies the practical expedient in paragraph 30 of the ED to the 100,000 performance obligations to supply a widget, combining them into one separate performance obligation (i.e., one performance obligation to supply 100,000 widgets), because they have the same pattern of transfer.

Manufacturer A determines the performance obligation to design the widget is satisfied

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over time in accordance with paragraph 35(b)(iii) and the supply of 100,000 widgets is a performance obligation satisfied over time in accordance with paragraph 35(b)(iii).

Three months into the contract, the market price of commodity X (a key component of the manufacture of widgets) increases, as does the cost to transport the widgets to Customer B. The revised cost of manufacturing is expected to exceed the allocated transaction price.

Performance obligations	Design services	Supply of 100,000 widgets
Allocated transaction price	CU 10,000	CU 90,000
Revised expected cost	CU 9,750	CU 92,500
Expected margin	**CU 250**	**CU (2,500)**

Manufacturer A is required to perform an IAS 37 onerous contract test since the performance obligation to supply 100,000 widgets involves the sale of inventories within the scope of IAS 2. The test in IAS 37 applies to the contract as a whole. Therefore, Manufacturer A recognises an onerous contract liability of CU2,250 (= CU2,500 - CU250).

In addition to the onerous test performed in accordance with IAS 37, Manufacturer A tests the performance obligation to supply 100,000 widgets in accordance with the ED because it is a performance obligation satisfied over a period of 18 months. Assuming that the lowest cost of settling the performance obligation is the cost to complete the contract (i.e., CU92,500), Manufacturer A would need to recognise a contract liability in accordance with paragraph 88 of the ED (i.e., CU2,500).

Paragraph 89 of the ED allows an entity to consider the impairment of contract cost assets before recognising a liability for an onerous performance obligation, but it does not clarify whether an entity can consider a liability already recognised for an onerous contract in accordance with IAS 37. As a result, it is not clear whether the entity would need to recognise a contract liability for the onerous performance obligation of CU2,500 or only an incremental adjustment to the existing IAS 37 onerous contract liability (i.e., CU250, being the difference between the liability recognised in accordance with IAS 37 and the onerous liability as measured in accordance with the ED).

It is not clear from the proposed wording of the consequential amendment to IAS 37 that IAS 37 may still apply to contracts with customers that are within the scope of the ED or in what circumstances IAS 37 could apply. We encourage the IASB to make these requirements more explicit and clear to ensure constituents understand their financial reporting requirements, particularly those related to the onerous contract test.

In addition, we believe that, at a minimum, both IAS 37 and the final revenue standard (when issued) should specifically highlight the potential interaction between the onerous tests in each standard. Further, application guidance may be needed to clarify at what amount an entity would recognise the related liabilities. That is, the onerous contract test in IAS 37 and the proposed test in the ED have different units of account and different measurement bases. Paragraph 68 of IAS 37 defines an onerous contract as one in which the unavoidable

Appendix D – Comments on the proposed consequential amendments to IFRS

costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. In contrast to the measurement basis in paragraph 88 of the ED, IAS 37 requires that if a contract is onerous, an entity measure and recognise the provision based on the best estimate of the expenditure required to settle the present obligation.

In light of these differences, an entity applying the requirements in both standards would likely measure the respective liabilities at different amounts and it is currently unclear whether both liabilities would be separately recognised or one liability would be recognised at the higher of the two calculated amounts. We would encourage the IASB to consider the potential interaction between the onerous contract test in IAS 37 and the test proposed in the ED.

Repurchase agreements

The ED defines forward contracts as financing arrangements if the entity will repurchase the asset for an amount that is equal to or more than the original selling price of the asset. As currently drafted, the ED's application guidance could apply to forward contracts that have a fixed price and to those that have a variable price. However, IFRS 9 and IAS 39 only illustrate fixed-price forward contracts. As a result, it is unclear what guidance an entity would apply to account for a variable-price forward contract. We request that the IASB provide additional guidance to clarify this point.

First-time adoption of IFRS

It is our understanding that, as a result of the proposed consequential amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* (in paragraph D2 of the ED), a first-time adopter of IFRS that adopts the final revenue standard (when issued) at the same time as it adopts IFRS would apply its requirements in their entirety, except for paragraphs C1, C2, C3(c) and C4-C6.

We support the proposal to allow first-time adopters to apply paragraphs C3(a), (b) and (d). However, in addition, we believe a first-time adopter should also be required to provide the disclosure required in paragraph C4. That is, if relief is applied, a first-time adopter, like an existing IFRS preparer applying the ED for the first time, should disclose which reliefs it has applied and provide a qualitative assessment of the estimated effect of that relief, to the extent reasonably possible.

We also believe a first-time adopter would need to apply paragraph C5 of the ED, to address situations where a first-time adopter early adopts the final revenue standard (when issued) before it adopts IFRS 9.

Business combinations

Contingent liabilities arising from a previous business combination

We encourage the IASB to specify the requirements for determining cumulative amortisation for a contingent liability arising from a previous business combination within IFRS 3 *Business Combinations*, without reference to the revenue standard (when issued).

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It is not clear from the proposed consequential amendments in paragraphs D3 (paragraph 56(b) of IFRS 3) and D9 (paragraph C5 of IFRS 9 (October 2010)) of the ED how an entity would determine cumulative amortisation and which principles of the ED an entity should consider when determining cumulative amortisation. If the intention is for an entity to consider the principle of the transfer of control, it is not clear what is being transferred. For example, consider an acquired contingent liability related to a court case. In this example, it is not clear what good or service an entity would consider when assessing the transfer of control.

If the IASB's intent is to amortise the initial carrying value of the contingency in profit or loss evenly over the period from acquisition of the business combination through to the resolution of the contingency, we would recommend the consequential amendment reflect this requirement without reference to the revenue standard (when issued).

<u>Financial instruments</u>

Financial guarantees

The proposed consequential amendments in paragraphs D9 (paragraphs 4.2.1(c)(ii) and C42 of IFRS 9 *Financial Instruments* (October 2010)), D23 (paragraphs IN6 and 47(c) of IAS 39 *Financial Instruments: Recognition and Measurement*) and D24 (paragraphs AG4(a) and AG48(a) of IAS 39) of the ED would require an entity to determine, in relation to a financial guarantee, the cumulative amount of income recognised as the obligation is satisfied in accordance with the principles of the ED. However, it is not clear from the proposed amendment what obligation they should consider when that obligation is satisfied. For example, is the obligation to stand ready or to pay cash in the event of default?

We would encourage the IASB to clarify which obligation an entity should consider when applying these requirements. In addition, we believe the proposed amendment could be read to imply that the obligation transfers over time because it states, "income recognised as the obligation is satisfied." We would encourage the IASB to amend this wording as follows: "income recognised <u>when (or</u> as<u>)</u> the obligation is satisfied."

Alternatively, if the IASB's intent is to recognise the initial carrying value of financial guarantee in profit or loss evenly over the guarantee period, we would recommend the consequential amendment reflect this requirement without reference to the revenue standard (when issued).

Loan commitments

The proposed consequential amendments in paragraphs D9 (paragraphs 4.2.1(d)(ii), B3.2.13(a) and C5 of IFRS 9 *Financial Instruments* (October 2010)) and D23 (paragraphs IN5 and 47(d) of IAS 39) of the ED would require an entity to determine, in relation to a loan commitment, the cumulative amount of income recognised as the obligation is satisfied in accordance with the principles of the ED. However, it is not clear from the proposed amendment what obligation they should consider when that obligation is satisfied. For example, is the obligation to stand ready or to provide a loan at a below-market interest rate?

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We encourage the IASB to clarify which obligation an entity should consider when applying these requirements. In addition, we believe the proposed amendment could be read to imply that the obligation transfers over time because it states, "income recognised as the obligation is satisfied." We encourage the IASB to amend this wording as follows: "income recognised when (or as) the obligation is satisfied."

Alternatively, if the IASB's intent is to recognise the initial carrying value of the loan commitment in profit or loss evenly over the commitment period, we would recommend the consequential amendment reflect this requirement without reference to the revenue standard (when issued).

Definition of dividends

The proposed consequential amendments in paragraphs D5 (Appendix A of IFRS 9 (November 2009)), D8 (Appendix A of IFRS 9 (October 2010)) and D23 (paragraph 9 of IAS 39) of the ED would define dividends as "distributions of profits to holders of equity investments…" We believe this definition should refer to equity instruments, and we recommend the definition be amended as follows: "Distributions of profits to holders of equity instrumentsinvestments in proportion to their holdings of a particular class of capital."

Income taxes

Currently paragraph D16 (paragraph 59(a) of IAS 12 *Income Taxes*) of the ED references IAS 39, but not IFRS 9. We recommend amending this consequential amendment to refer to both IAS 39 and IFRS 9. Alternatively, IFRS 9 could include a consequential amendment to amend paragraph 59(a) IAS 12 to replace the reference to IAS 39 in that paragraph with a reference to IFRS 9.

Service concession arrangements

The consequential amendments to paragraphs 14 and 20 of IFRIC 12 *Service Concession Arrangements* would require operators to account for revenue relating to construction or upgrade services and operation services in accordance with the revenue standard (when issued). However, it is unclear why an operator would not also consider the requirements of that standard in relation to the related costs.

Currently, operators are required to apply the requirements of IAS 11 and IAS 18 in relation to costs. With the withdrawal of these standards, it is not clear what guidance service concession operators would apply in relation to costs to obtain or fulfil a contract. We recommend amending the proposed consequential amendments to paragraphs 14 and 20 of IFRIC 12 to require operators to account for both revenue and costs in accordance with the revenue standard (when issued).

Barter advertising transactions

SIC-31 *Revenue-Barter Transactions Involving Advertising Services* provides specific guidance for barter advertising transactions. Specifically, this interpretation addresses the circumstances in which a seller can reliably measure revenue at the fair value of advertising

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services received or provided in a barter transaction, when dissimilar advertising services are being exchanged.

Because this interpretation will be superseded and similar guidance is not currently included in the ED, we are concerned that an opportunity for entities to overstate revenue by recognising revenue and associated costs on barter advertising transactions may again exist. We do not believe paragraph 14(a) of the ED, which would require that a contract has commercial substance, provides sufficient guidance to result in consistent and appropriate conclusions. Therefore, we believe additional guidance should be included to address these transactions, or these paragraphs should be included within the application guidance to the final revenue standard (when issued).

Other

The current definition of "revenue" in IAS 18 refers to "the gross inflow" whereas the definition in the proposed model refers to the definition of "income," and that definition does not mention the word "gross." The definition of income in the proposed model comes from the IASB's conceptual framework, but the definition in the conceptual framework is intended to be a net concept. For example, if an entity has goods with a cost of $80 and sells them for $100 cash, then the "increase" in economic benefits and the resulting "increase" in equity is only $20, whereas the proposed model requires the revenue recognised to be $100 (assuming the entity is the principal in the arrangement). We request that the IASB ensure consistent definitions between the conceptual framework and the proposed standard. We understand that this may mean amending the conceptual framework.