EFRAG
European Financial Reporting Advisory Group

**DRAFT COMMENT LETTER**
**Comments should be submitted by 9 March 2012 to**
**Commentletters@efrag.org**

*Notes to constituents:*

*EFRAG will field-test the revised proposals, during its consultation period. The field-testing activities, and their role, are further explained in Appendix 3. The views expressed in this letter do not yet reflect the results of the field-test.*

XX March 2012

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam,

**Re: Revenue from Contracts with Customers**

On behalf of the European Reporting Advisory Group (EFRAG), I am writing to comment on the revised exposure draft, *Revenue from Contracts with Customers* issued by the IASB on 14 November 2011 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

EFRAG welcomes the IASB's decision to re-expose the proposals. We note that several significant changes to the original proposals (the '2010 ED') have been made based on feedback received from constituents. The re-exposure provides constituents with an opportunity to comment on these changes and assess whether the revised requirements are easily understandable and can be implemented in practice without unjustified costs or difficulties.

In general, EFRAG welcomes the changes made to the 2010 ED. However, EFRAG disagrees with the proposals to:

- limit the onerous test to performance obligations satisfied over a period of time greater than one year;
- perform the onerous test at a performance obligation level;
- offset advances received against contract assets in all circumstances;

- allocate contingent amounts either to all or only to one performance obligation;
- require a list of specific disclosure requirements in IAS 34 *Interim Financial Reporting*; and
- include only sales-based variable consideration in the scope of paragraph 85 of the ED.

In addition, EFRAG thinks that clarification is needed on:

- determining whether or not a contract is a contract with a customer, or a contract with a partner or collaborator;
- how to allocate contingent amounts of consideration to distinct goods or services;
- how payments should be allocated to transfers of goods and services when considering the time value of money;
- when consideration should be regarded as variable consideration;
- whether contracts for which the entire amount of consideration is contingent on the customer's future sales are within the scope of paragraph 85 of the ED;
- how to distinguish between sale with a right of return, put options and customer acceptance clauses;
- whether an entity is allowed to estimate the customer's underlying sales in a reporting period for contracts within the scope of paragraph 85 of the ED; and
- the wording of the amendments to IAS 16, IAS 38 and IAS 40.

Our detailed responses to the questions in the ED are set out in Appendix 1, while Appendix 2 includes some additional comments for the IASB's consideration. [Appendix 3 includes the results of EFRAG's field-tests of the proposals collected to date. We note that we will provide further results of the field-tests to the IASB during its re-deliberation of the proposals.]

If you would like to discuss our comments further, please do not hesitate to contact Rasmus Sommer or me.

Yours sincerely,

Françoise Flores

**EFRAG Chairman**

**APPENDIX 1**

**EFRAG's responses to the questions raised in the exposure draft**

**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 recognises 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?

***Notes for EFRAG's constituents***

1 *Paragraph 35 of the ED states that an entity transfers control of a good or service over time and, hence, satisfies a performance obligation and recognises revenue over time if at least one of the following two criteria is met:*

(a) *the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced;*

(b) *the entity's performance does not create an asset with an alternative use to the entity and at least one of the following criteria is met:*

(i) *the customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs;*

(ii) *another entity would not need to substantially re-perform the work the entity has completed to date if that other entity were to fulfil the remaining obligation to the customer. In evaluating this criterion, the entity shall presume that another entity fulfilling the remainder of the contract would not have the benefit of any asset (for example, work in progress) presently controlled by the entity;*

(iii) *the entity has a right to payment for performance completed to date and it expects to fulfil the contract as promised.*

*2 Currently, percentage-of-completion accounting is required according to IAS 18* Revenue *when:*

(a) *an agreement is for the rendering of services (paragraph 20 of IAS 18), or*

(b) *control and the significant risks and rewards of ownership are transferred to the buyer continuously.*

*3 If these conditions are not met, percentage-of-completion accounting can only be applied when the contract is within the scope of IAS 11* Construction Contracts*.*

*4 IFRIC 15* Agreements for the Construction of Real Estate *provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of IAS 11 or IAS 18. According to IFRIC 15 an agreement for the construction of real estate is a construction contract within the scope of IAS 11 only when the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress.*

*5 Paragraph 53 of the ED states that the promised amount of consideration in a contract can vary because of discounts, rebates, refunds, credits, incentives, performance bonuses, penalties, contingencies, price concessions or other similar items.*

*6 If the amount of consideration to which an entity expects to be entitled is variable, the cumulative amount of revenue the entity recognises to date shall 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 of consideration allocated to satisfied performance obligations only if both of the following criteria are met:*

(a) *the entity has experience with similar types of performance obligations (or has other evidence such as access to the experience of other entities); and*

(b) *the entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.*

***EFRAG's response***

**EFRAG agrees with the proposed requirements.**

*7* In its comment letter in response to the 2010 ED and during the re-deliberations following the 2010 ED, EFRAG's two main concerns were that:

(a) the proposals did not result in revenue being recognised over time when this approach would provide the most useful information, and

(b) revenue could be recognised without the entity being reasonably assured of having a right to consideration.

*8* As explained below, EFRAG considers that the above concerns have now been solved in the ED.

*Revenue being recognised over time*

*9* EFRAG appreciates that the IASB has now included specific guidance on when an entity satisfies a performance obligation over time.

*10* EFRAG agrees with the proposed criteria in paragraphs 35 and 36 of the ED. In our view, the new proposed criteria for when an entity satisfies a performance obligation over time are sensible and reflect that the IASB has listened to the criticism expressed by its constituents in response to the 2010 ED.

11 We think it is an improvement compared with the current requirements that percentage-of-completion accounting in many cases shall be applied for a long-term contract although the contract neither deals with the construction of a significantly customised good nor meets the criteria of IAS 18 for percentage-of-completion accounting.

12 For example, if an entity is constructing ten standard houses on its own land, a customer can agree to purchase a house to be constructed on a specific tract of land. By entering into such a contract, the entity would be prohibited from selling that house to someone else, unless the customer does not meet its obligations under the contract to pay the agreed consideration. As the contract is for a standard house, it would not allow the customer to specify major structural elements of the building. Accordingly, this contract would not be in the scope of IAS 11. When the requirements of IAS 18 for percentage-of-completion accounting are not met, current requirements therefore prohibit the use of percentage-of-completion accounting when constructing the house.

13 However, we understand that the ED would consider the construction of such a house as a performance obligation to be satisfied over time, provided that the entity has a right to consideration for the performance to date and the entity is expected to fulfil the contract as promised. This is because the proposals do not consider customisation of the house to be a deciding factor in determining if a performance obligation is satisfied over time, but rather consider whether it has an alternative use for the entity. According to paragraph 36 of the ED an asset would not have an alternative use to an entity if the entity at contract inception is unable, either contractually or practically, to readily direct the asset to another customer. Given the contractual restriction, the entity in the example above cannot sell the house to another customer. The house does therefore not have an alternative use for the entity and the performance obligation is considered to be satisfied over time.

*Right to consideration*

14 We note that the proposed requirements could result in revenue being recognised in cases where the entity does not have a right to consideration. That could happen when either criterion (a), (b)(i) or (b)(ii) in paragraph 35 of the ED is met without criterion (b)(iii) being met. In these cases, the entity has transferred something to the customer without having a current right to payment. In line with the concerns expressed in response to the 2010 ED, EFRAG is concerned that, without further guidance, this would result in revenue being reported for which future entitlement to payment remains in question.

15 However, further guidance is now provided in the ED, and EFRAG understands that when an entity has transferred a good or a service to a customer, but the entire consideration is contingent on future events, the consideration should be considered variable. According to paragraph 82 of the ED, this means that the cumulative amount of revenue recognised must not exceed the amount to which the entity is reasonably assured to be entitled.

16 We think this requirement appropriately limits the revenue figure to amounts that the entity is sufficiently certain to be entitled to and the proposals will thus result in useful revenue information for users.

**Question 2**

Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 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?

***Notes for EFRAG's constituents***

*17 The ED states that for an unconditional right to consideration (i.e. a receivable), an entity shall account for the receivable in accordance with IFRS 9. An entity shall similarly account for the effects of a customer's credit risk on a contract asset.*

*18 As EFRAG is split on the issue, it has decided to ask constituents for their views on how uncollectible amounts should be accounted for and presented. Constituents may want to consider the following arguments and issues that have been raised in EFRAG's discussions on these issues:*

(a) Need for guidance on presentation – *Those who favour guidance on the presentation of uncollectible amounts argue that such guidance will enhance consistency in practice. However, others argue that it would result in a rules-based approach and that the principles-based guidance in IAS 1* Presentation of Financial Statements *is sufficient as it has worked appropriately in the past.*

(b) Different treatments for contract assets and receivables – *Receivables are included in the scope of IFRS 9, while contract assets are not. Therefore, some believe that a distinction should be made between receivables and contract assets. Receivables should be accounted for in accordance with the requirements for financial instruments, while contract assets should be accounted for under guidance that is to be included in the standard on revenue recognition. Impairment losses on receivables should be presented separately from impairment losses on contract assets, because presenting the impairment losses on financial instruments together with impairment losses on contract assets would seem inconsistent with the distinction that IAS 1 makes between gains, losses and costs arising from financial instruments and non-financial instruments. In addition, some think that impairment should be assessed differently for contract assets and receivables in order to maintain current practice in relation to contract assets.*

*Others argue that making the above distinction would not result in useful information as the impact on a company's performance and financial position would be exactly the same, regardless of whether the deterioration of a customer's credit rating affects a receivable or a contract asset. They also note that making a distinction means that credit related losses on contract assets would reduce the gross margin while similar credit related losses on receivables would be presented as a non-operating financial expense.*

(c) Distinguishing between the initial recognition and subsequent remeasurement of uncollectible amounts – *Some argue that presenting impairment losses in a line item adjacent to the revenue line would both provide useful information about the gross revenue and the associated collectability.*

*Others note, however, that the usefulness of the information resulting from this presentation is significantly reduced because the loss figure combines initial expectations and subsequent adjustments. The subsequent experience adjustments relates to revenue that was recognised in earlier periods and it is unhelpful to present these as if they related to the gross revenue for the current period. Some, therefore, suggest that the subsequent experience adjustments should be presented in a separate line item. Although it has been noted that this solution differs from how initial estimates and subsequent changes are accounted for in other areas and the result would be sensitive to inaccuracies in how entities initially estimate impairment losses.*

*Yet another view is that impairment losses should not be considered as adjustments to revenue, as it is not related to an entity's selling activities but to payment collection activities. Accordingly, impairment losses should be presented after the costs more directly related to generating the revenue.*

(d) Placement of guidance on impairment of receivables – *Some argue that requiring the application of IFRS 9 guidance to impairment of both receivables and contract assets would result in the application of complex guidance to simple transactions. They do not support this because in such*

*cases no significant impairment losses are initially expected. While the guidance on impairment in IFRS 9 might be appropriate for financial institutions, it would not result in a sensible trade off between costs and benefits when applied to trade receivables. Therefore, the revenue recognition standard should include requirements on accounting for impairment losses on trade receivables and contract assets that are consistent with the principles in IFRS 9, but that are simpler to apply.*

*Others, however, argue that it would be inconsistent, and sometimes even more complex, to account differently for similar financial assets that have just arisen differently. In addition, to the extent that impairment losses are not material, it is not necessary to apply very sophisticated techniques to make the estimates that are required for financial instruments.*

**Question to constituents**

19 EFRAG is asking constituents for their views on the following:

(a) In which standard(s) do you think guidance for impairment of conditional and unconditional rights to consideration should be provided?

(b) Should specific guidance be developed for how to present uncollectible amounts or should the general guidance of IAS 1 be applied?

(c) If you think specific guidance should be provided:

(i) Should this guidance be included in the standard on revenue recognition or in IAS 1?

(ii) How should uncollectible amounts be presented in the statement of comprehensive income initially?

(iii) How should subsequent changes in the estimates of uncollectible amounts be presented in the statement of comprehensive income?

**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 recognises 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 recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

***Notes for EFRAG's constituents***

*20 Under the heading "Variable consideration", paragraph 53 of the ED states:*

*'The promised amount of consideration in a contract can vary because of discounts, rebates, refunds, credits, incentives, performance bonuses, penalties, contingencies, price concessions or other similar items.'*

21 *The ED states in paragraph 81 that if the amount of consideration to which an entity expects to be entitled is variable, the cumulative amount of revenue the entity recognises to date shall not exceed the amount to which the entity is reasonably assured to be entitled. The entity is reasonably assured only if both of the following criteria are met:*

(a) *the entity has experience with similar types of performance obligations or has other evidence such as access to the experience of other entities; and*

(b) *the entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.*

22 *The ED states in paragraph 83 that an entity shall use judgement and consider all facts and circumstances when evaluating whether the entity's experience is predictive of the amount of consideration to which it will be entitled. Indicators that an entity's experience (or other evidence) is not predictive of the amount of consideration to which the entity will be entitled are listed in paragraph 82 of the ED and include, but are not limited to:*

(a) *the amount of consideration is highly susceptible to factors outside the entity's influence;*

(b) *the uncertainty about the amount of consideration is not expected to be resolved for a long period of time;*

(c) *the entity's experience (or other evidence) with similar types of performance obligations is limited; and*

(d) *the contract has a large number and broad range of possible consideration amounts.*

23 *Paragraph 85 of the ED states that notwithstanding the above requirements, if an entity licences intellectual property to a customer and the customer promises to pay an additional amount of consideration that varies on the basis of the customer's subsequent sales of a good or service (e.g. a sales-based royalty), the entity is not reasonably assured to be entitled to the additional amount of consideration until the uncertainty is resolved (i.e. when the customer's subsequent sales occur).*

***EFRAG's response***

**EFRAG agrees with the proposed requirements. However, we think the wording should better reflect the scope of the requirements and do not agree with one of the suggested indicators listed in paragraph 82 of the ED. Finally we have some comments on paragraph 85 of the ED.**

24 While EFRAG agrees with the criteria in paragraph 81 of the ED, we do not agree with the indicator listed in paragraph 82(b) of the ED, as we do not think the time it takes to resolve an uncertainty influences whether or not an entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled.

25 In addition, we think the scope of the requirements in paragraph 81 should be clarified. Paragraph 81 refers to situations where the "consideration to which an entity expects to be entitled is variable". Paragraph 53 of the ED lists the factors that result in an amount being variable according to the ED. We note that this list includes contingencies. EFRAG agrees that contingencies should be accounted for similarly to variable amounts. However, EFRAG is concerned that this may not always happen for the simple reason that many do not consider contingent amounts to be the same as variable amounts. Instead contingencies are associated with uncertain amounts. To avoid any misunderstandings, we would recommend the IASB to refer to variable and uncertain amounts of consideration when currently only referring to variable amounts.

26 We generally agree with paragraph 85 of the ED, but we consider the paragraph to represent an exception to the general requirements of the ED, particularly those in paragraphs 81 to 84. If an entity, for example, sells a licence to a customer and the consideration depends fully on the customer's subsequent sales, it is possible that the entity is still reasonably assured that the customer will sell a given minimum quantity. Paragraphs 81 to 84 would therefore require revenue to be recognised at the time when the customer is able to use the licence and at an amount based on the minimum quantity the entity would be reasonably assured the customer would sell. However, paragraph 85 requires recognition of revenue to be postponed until the customer's subsequent sales occur. While EFRAG considers this treatment to be in conflict with the more general requirements, EFRAG notes that both users and preparers according to paragraph BC203 of the Basis for Conclusions did not consider it useful to apply the general requirements in the situations covered by paragraph 85 of the ED. We, therefore, agree with the decision of the IASB to include an exception to the general requirements in order to make the information provided useful.

27 This being said, we have the following comments on paragraph 85:

(a) EFRAG thinks it is necessary to consider the scope of the paragraph. In paragraph BC203 of the Basis for Conclusions, it appears as if the paragraph has been introduced to consider situations where factors outside the entity's control could subsequently affect the amount of revenue recognised. In some of these circumstances, an entity would be required to report, throughout the life of the contract, significant adjustments to the amount of revenue recognised at inception of the contract as a result of changes in circumstances. This is considered not to result in useful information. Sales-based royalties are mentioned as an example of such a situation.

As sales-based royalties are just mentioned as an example in paragraph BC203 of the Basis for Conclusion, it is unclear why paragraph 85 of the ED only covers sales-based considerations. In the view of EFRAG, there are many other situations where factors outside the entity's control could affect the amount of revenue recognised and result in significant adjustments to the amount of revenue recognised at inception. For example, it appears as if the paragraph does not cover cases in which an entity is licensing intellectual property for a consideration that varies based on the customer's subsequent production of goods. As the customer's production in many cases will depend on its ability to sell the resulting goods, EFRAG does not understand why a sales-based royalty according to the ED shall be accounted for differently than a production-based royalty. EFRAG believes that the IASB should provide a more robust conceptual argument for the scope exception in paragraph 85.

(b) As we will further explain in paragraphs 3 - 4 in Appendix 2, we find it difficult to distinguish between contracts covered by paragraph 85 and those that are scoped out in the ED because the counterparty is not a customer but a collaborator or a partner according to paragraph 10 of the ED. We therefore think the IASB has to clarify this distinction.

(c) Paragraph 85 of the ED refers to 'an additional amount of consideration', which suggests, contrary to the intention we believe, that it only applies in circumstances where the consideration consists of a fixed part and a variable part that depends on the level of the customer's subsequent sales. EFRAG believes that the guidance should also apply to contracts that do not contain a fixed part, because we do not think that contracts where the consideration includes an insignificant fixed amount should be accounted for differently than contracts where the entire consideration varies on the basis of the customer's subsequent sales. Consequently, we think paragraph 85 should be amended as follows:

> Notwithstanding the requirements in paragraphs 81-83, if an entity licences intellectual property (see paragraph B33) to a customer and the customer promises to pay an ~~additional~~ amount of consideration that is fully or partly contingent ~~that varies~~ on ~~the basis of~~ the customer's subsequent sales of a good or service (for example, a sales-based royalty), the entity is not reasonably assured to be entitled to the ~~additional~~ part of the amount of consideration that is contingent on the customer's subsequent sales until the uncertainty is resolved (ie when the customer's subsequent sales occur).

(d) We think the IASB should clarify that when a contract is within the scope of paragraph 85 of the ED, an entity may need to estimate the customer's underlying sales in the reporting period. In particular, we believe the IASB should clarify that if an entity is uncertain about whether its customer will sell anything; the entity should not recognise any revenue until the customer has sold something. However, if the entity has some kind of evidence that the customer is selling goods using the license, the entity is allowed to estimate the customer's sales in a given reporting period and hence recognise revenue from the licence in that period (although this amount will be revised when the exact selling figures are reported by the customer).

**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 recognise 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 scope do you recommend and why?

***Notes for EFRAG's constituents***

*28 For a performance obligation that an entity satisfies over time and that the entity expects at contract inception to satisfy over a period of time greater than one year, an entity shall recognise a liability and a corresponding expense if the performance obligation is onerous.*

*29 A performance obligation is onerous if the lowest cost of settling the performance obligation exceeds the amount of the transaction price allocated to that performance obligation. The lowest cost of settling a performance obligation is the lower of the following amounts:*

(a) *the costs that relate directly to satisfying the performance obligation by transferring the promised goods or services;*

(b) *the amount that the entity would pay to exit the performance obligation if the entity is permitted to do so other than by transferring the promised goods or services.*

***EFRAG's response***

**EFRAG does not agree with the proposal. EFRAG believes that: (1) the onerous test should be performed at a contract level, and (2) it should cover all contracts with customers.**

30 EFRAG disagrees with the proposals of the ED that the onerous test should be performed at the performance obligation level and should be limited to obligations that an entity satisfies over a specified period of time. EFRAG thinks that the onerous test should be performed at a contract level and should cover all contracts with customers.

The onerous test should be performed at a contract level

*31* EFRAG thinks that the onerous test should be performed at a contract level rather than at the level of the performance obligation, as we consider this would result in more useful information. We do not think a future loss related to a performance obligation within an overall profitable contract represents a liability for an entity.

*32* Paragraph BC207 of the Basis for Conclusions states that the onerous test is suggested to be performed at the level of the performance obligation, because considering the contract as the unit of account would:

(a) add complexity;

(b) be inconsistent with recognising revenue at the performance obligation level; and

(c) be arbitrary because the unit of account would depend on whether the entity provides its goods or services in one contract or in more than one contract.

33 EFRAG does not consider these arguments to be convincing. Firstly, it is not clear from the Basis for Conclusions why the IASB thinks it adds complexity to perform the onerous test at a contract level rather than the level of the performance obligations. EFRAG is not aware that current requirements of IFRS, that require the test to be performed at a contract level, are considered complex. The responses to the 2010 ED, which showed that most respondents thought the onerous test should be performed at a contract level, confirm that constituents do not think that it is complex to do so. If it is the new model for revenue recognition that adds the complexity, we think this is the issue that should be resolved.

34 Secondly, while we appreciate that it might be more consistent with the proposed model to perform the onerous test at the level of the performance obligation as revenue is recognised at the performance obligation level, it introduces other inconsistencies. In particular, losses recognised on individual performance obligations in an overall profitable contract would not meet the definition of a liability under the IASB's Conceptual Framework. Similarly, the approach would be inconsistent with IAS 37 *Provisions, Contingent Liabilities and Contingent*

*Assets*, which applies to 'contracts' as a whole, rather than to elements within contracts, and in fact prohibits recognition of future operating losses.

35 Thirdly, from the Basis for Conclusion it appears to be the IASB's view that performing the onerous test at the level of the contract could result in arbitrary outcome because the ED does not appropriately describe how to bundle promised goods and services into contracts. The unit of account therefore depends on whether the entity provides its goods or services in one contract or in more than one contract. If the ED does not provide sufficient guidance on how to combine and segment contracts for the purpose of revenue recognition, we think this issue should be addressed instead of applying this weakness as an argument for applying the onerous test at the level of the performance obligation.

<u>The scope of the onerous test should not be limited</u>

36 Paragraph BC208 of the Basis for Conclusions states that limiting the scope of the onerous test to performance obligations that are satisfied over a period of time that is greater than one year, limits the risk of unintended consequences of applying the onerous test to some contracts. Paragraph BC208 argues that this scope is closest to the scope of the existing revenue standard that specifies an onerous test (i.e. IAS 11). However, this ignores the onerous test in IAS 37, which applies to contracts that are not covered by IAS 11.

37 According to paragraph D21 of the ED, IAS 37 should not apply any longer to rights and obligations arising from contracts with customers within the scope of the ED. The ED will therefore result in no onerous test for:

(a) performance obligations that are satisfied over a period of time that is less than one year; and

(b) performance obligations that are satisfied at a point in time (in the future).

38 We do not agree with this outcome. For example, we think it is inconsistent that an 11-month contract would not be tested, while a 13-month contract would be covered by the onerous test even though the loss on the 11-month contract could be significantly higher than the loss on the 13-month contract.

39 We acknowledge that assets developed to satisfy performance obligations should still be tested for impairment and that the IASB has not removed the reference to IAS 37 in paragraph 31 of IAS 2 *Inventories*. However, for some contracts where the loss is not related to the purchase of inventory within the scope of IAS 2, there may be a period where there is no asset to impair or the measurement of the asset cannot include the total loss on the performance obligation or contract. In these situations we consider the existence of an onerous test to be important.

40 Limiting the onerous test as suggested in the ED will result in fewer cases where a performance obligation within an overall profitable contract is deemed onerous at contract inception as a result of the proposed requirements on how to allocate the transaction price and discounts to separate performance obligations. When we oppose to limiting the scope of the onerous test, we realise that the cases described will appear more frequently everything being equal. We would therefore like to repeat the comment included in our comment letter in response to the 2010 ED that the transaction price should be allocated to performance obligations based on the margins of the performance obligations. This would reduce the problem of performance obligations being deemed onerous as a result of the allocation of an overall discount. Paragraph BC191 of the Basis for Conclusions explains that

allocation on the basis of margins would require an entity to estimate the costs to satisfy a performance obligation, which would add additional complexity and different treatments in the way costs are allocated to performance obligations could significantly affect the calculation. EFRAG notes, however, that the onerous test suggested by the IASB requires that costs are allocated to performance obligations. In addition, IAS 2 and the proposals include requirements on how to determine the costs related to satisfying a performance obligation. EFRAG does therefore not assess allocating the transaction price based on margins to be overly complex.

41 We also think that in cases where a performance obligation becomes onerous after the initial allocation of the transaction price, the loss on one performance obligation within an overall profitable contract should be allocated to remaining performance obligations based on their margins, so that no loss on an overall profitable contract is recognised.

**Question 5**

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

(a) The disaggregation of revenue (paragraphs 114 and 115);

(b) A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117);

(c) An analysis of the entity's remaining performance obligations (paragraphs 119–121);

(d) 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);

(e) A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil 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 reports? 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 reports.

***Notes for EFRAG's constituents***

*42 IAS 34 requires an entity to include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Paragraph 15B of IAS 34 includes a list of 13 events and transactions for which disclosures would be required if they are significant (the list is not exhaustive).*

*43 In addition to disclosing significant events and transaction, paragraph 16A of IAS 34 requires an entity to include information on nine specific areas in the notes*

*to its interim financial statements, if not disclosed elsewhere in the interim financial report.*

***EFRAG's response***

**EFRAG disagrees with the proposal as it does not consider the list of specific requirements to be in accordance with the principles on which IAS 34 is based.**

44 EFRAG acknowledges that revenue is an important figure and information about it should therefore be included in interim financial reports. However, we do not consider the list of specific requirements proposed in the ED to be in accordance with the principles underlying IAS 34 *Interim Financial Reporting.*

45 Currently IAS 34 paragraph 16A includes a list of only nine items for which disclosures should always be provided, if material. In addition, IAS 34 paragraph 15 requires an entity to explain events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. This information should provide an update of the relevant information presented in the most recent annual financial report.

46 EFRAG believes that the existing approach to disclosures in IAS 34 strikes the right balance between requiring information that is relevant to users and the costs to preparers. We are concerned that increasing the number of specific requirements would set a precedent that could lead to excessively detailed and unbalanced disclosure requirements for interim reporting which, among other things, could also affect the timeliness of this reporting. If the IASB is concerned about the adequacy of interim reporting under IAS 34 then it should investigate that as part of a separate project on interim reporting.

**Question 6**

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

***Notes for EFRAG's constituents***

*47 Appendix D of the ED includes in paragraphs D17, D22 and D26 amendments to IAS 16 Property, Plant and Equipment, IAS 38 Intangible Assets and IAS 40 Investment Property. The purpose of the amendments is to require that an entity apply (a) the proposed requirements of the ED on control to determine when to derecognise an asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset.*

*48 Paragraph BC349 of the ED explains that in IFRSs, an entity selling an asset within the scope of IAS 16* Property, Plant and Equipment*, IAS 38 or IAS 40* Investment Property *applies the recognition principles of IAS 18 to determine when to derecognise the asset and, in determining the gain or loss on the sale, measures the consideration at fair value. However, the IASB understands that*

*there is diversity in practice when the sale of those assets involves contingent consideration. Accordingly, to improve the accounting in IFRSs and ensure consistency with US GAAP, the IASB decided to amend those standards to require an entity to apply the recognition and measurement principles of the proposed requirements to sales of assets within the scope of those standards. The IASB decided that a reasonably assured constraint on the amount of consideration used in determining the gain or loss recognised should also apply to the sale of assets that are not an output of the entity's ordinary activities. This is because an entity faces similar if not greater challenges in determining the transaction price when the asset is not an output of the entity's ordinary activities than when the asset is an output of its ordinary activities.*

***EFRAG's response***

**EFRAG agrees with the idea behind the proposal but believes the wording of the consequential amendments should be improved.**

49 EFRAG agrees that the proposals should be applied to the transfer of non-financial assets that are not an output of an entity's ordinary activities, as this is consistent with the current approach under IFRS.

50 We are, however, concerned that the wording of the amendments will not always result in transfer of non-financial assets, that are not an output of an entity's ordinary activities, being accounted for similarly to output of an entity's ordinary activities. We note, for example, that:

(a) The amendments to paragraph 72 of IAS 16, paragraph 116 of IAS 38, and paragraph 70 of IAS 40 restricts the recognition of income to the amount to which the entity is reasonably assured. When accounting for an entity's ordinary activities according to the ED that constraint only applies when the amount of consideration is variable.

(b) The amendments to paragraph 72 of IAS 16, paragraph 116 of IAS 38, and paragraph 70 of IAS 40 state that subsequent changes to the estimated amount of consideration that is reasonably assured shall be recognised as a gain or loss in the period of the change in accordance with IAS 8. By referring to IAS 8 instead of the ED, it seems unclear whether the proposed requirements for allocating subsequent changes in the transaction price to separate performance obligations that applies for output of an entity's ordinary activities should also apply when selling assets included in the scope of IAS 16, IAS 38 or IAS 40.

51 To enhance consistency when accounting for the sale of assets that are not output of an entity's ordinary activities and sale of output form an entity's ordinary activities, EFRAG suggests the references in IAS 16, IAS 38 and IAS 40 to the requirements of the ED be made more general. This can be done by simply stating that the requirements of the ED should be applied when determining when control has passed (and an asset should be derecognise), and when measuring the amount of gain or loss to recognise upon derecognition of the asset.

**APPENDIX 2**

**Additional comments**

1 In addition to commenting on the specific questions raised in the ED, EFRAG would like to comment on the following issues:

(a) scope;

(b) allocation of contingent amounts;

(c) time value of money;

(d) offsetting contract assets and advances received;

(e) financial assets and performance obligations;

(f) right of return;

(g) disclosures; and

(h) early application and effective date.

**Scope**

***Notes for EFRAG's constituents***

*2 The proposals in the ED only apply if the counterparty to the contract is a customer. Paragraph 10 of the ED notes that for some contracts the counterparty to the contract might not be a customer, but rather a collaborator or a partner that shares with the entity the risks and benefits of developing a product to be marketed. Such contracts are not in the scope of the proposal.*

***EFRAG's view***

***EFRAG thinks the guidance is unclear on determining whether or not a contract is a contract with a customer or a contract with a partner or collaborator.***

3 EFRAG notes that paragraph 10 of the ED explicitly states that the proposals do not apply to a contract with a collaborator or a partner. We appreciate that it could also be argued that the current requirements in IAS 18 *Revenue* and IAS 11 *Construction Contracts* do not apply to such contracts. However, we note, for example, that paragraph 85 of the ED is dealing with the case where an entity licences intellectual property to another party and the consideration varies based on that party's subsequent sales. Whether one regards such counterparty as a customer rather than a collaborator or partner is a matter of considerable debate.

4 Therefore, EFRAG believes that to avoid divergence in practice – for example when part of the consideration is variable and depends on the success of the counterparty – the IASB should provide further guidance on when a counterparty is considered to a collaborator or a partner rather than a customer.

**Allocation of contingent amounts**

**Notes for EFRAG's constituents**

5 *Paragraph 75 of the ED states that an entity shall allocate a discount entirely to one (or some) separate performance obligation(s) in the contract if both of the following criteria are met:*

(a) *the entity regularly sells each good or service (or each bundle of goods or services) in the contract on a stand-alone basis; and*

(b) *the observable selling prices from those stand-alone sales provide evidence of the performance obligation(s) to which the entire discount in the contract belongs.*

6 *Paragraph 76 of the ED states that if the transaction price includes an amount of consideration that is contingent on a future event or circumstance (for example, an entity's performance or a specific outcome of the entity's performance), the entity shall allocate that contingent amount (and subsequent changes to the amount) entirely to a distinct good or service if both of the following criteria are met:*

(a) *the contingent payment terms for the distinct good or service relate specifically to the entity's efforts to transfer that good or service (or to a specific outcome from transferring that good or service); and*

(b) *allocating the contingent amount of consideration entirely to the distinct good or service is consistent with the allocation principle in paragraph 70 when considering all of the performance obligations and payment terms in the contract.*

***EFRAG's view***

**EFRAG agrees that discounts and contingent consideration shall sometimes be allocated to particular performance obligations within a contract. However, EFRAG thinks the requirements on how to allocate contingent amounts of consideration to distinct goods or services should be clarified.**

7 In its comment letter in response to the 2010 ED, EFRAG disagreed with the requirements that the transaction price, and changes in the transaction price, should in all cases be allocated to different performance obligations based on the initial standalone selling prices. EFRAG thought that facts and circumstances should be considered in making the allocation. EFRAG is therefore pleased that the IASB has introduced exemptions to the strict allocation based on standalone selling prices in cases of discounts and contingent consideration. We have, however, two comments regarding paragraph 76 of the ED:

(a) Paragraph 76 of the ED states that if the transaction price includes an amount of consideration that is contingent on a future event or circumstance, the entity shall allocate that contingent amount entirely to a distinct good or service if certain criteria are met.

EFRAG thinks that in some cases, it would only be possible to reflect the economics underlying a transaction by allocation a contingent amount to more than one (but not necessarily all) performance obligations included in a contract. Where the contingent amount directly relates to the cost of several inputs (e.g. number of user licenses in an IT system), EFRAG believes that

the contingent amount should be allocated proportionately to the underlying performance obligations (even if there is more than one). However, paragraph 76 of the ED does not allow this as it states that the entity shall allocate the contingent amount entirely to a distinct good or service.

We note that paragraph 75 of the ED allows an entity to allocate a discount to several separate performance obligations, as it states that "an entity shall allocate a discount entirely to one (or some) separate performance obligation(s) in the contract." EFRAG does not see any reason why a rebate can be allocated to several (but not all) performance obligations, but a contingent amount cannot.

(b) EFRAG thinks that the reference in paragraph 76(b) of the ED to the principle in paragraph 70 is confusing and somewhat circular, because paragraph 76 is in fact an exception to the general application of the principle in paragraph 70 as explained in paragraphs 71 to 74. Therefore, we believe it would be better to clarify what is meant by paragraph 76(b) or to delete the reference.

**Time value of money**

***Notes for EFRAG's constituents***

*8 The ED states that when determining the transaction price an entity shall adjust the promised amount of consideration to reflect the time value of money if the contract has a financing component that is significant to the contract.*

*9 In assessing whether a financing component is significant to a contract, an entity shall consider various factors including, but not limited to, the following:*

(a) *The expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services.*

(b) *Whether the amount of consideration would substantially differ if the customer paid in cash promptly in accordance with typical credit terms in the industry and jurisdiction.*

(c) *The interest rate in the contract and prevailing interest rates in the relevant market.*

*10 As a practical expedient, paragraph 60 of the ED states that an entity need not to adjust the promised amount of consideration to reflect the time value of money if the entity expects at contract inception that the period between payment by the customer of all or substantially all of the promised consideration and the transfer of the promised goods or services to the customer will be one year or less.*

*11 To adjust the promised amount of consideration to reflect the time value of money, an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract as well as any collateral or security provided by the customer or the entity, which might include assets transferred in the contract. An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the cash selling price of the good or service. After contract inception, an entity shall not update the discount rate for changes in circumstances or interest rates.*

*12 As reflected below, EFRAG considers it necessary that the IASB clarifies how to allocate different payments to various transfers of promised goods or services. In addition EFRAG is split on the practical expedient referred in paragraph 10 above:*

(a) *Some EFRAG members support the practical expedient included in the ED for cost/benefit and consistency reasons. These members acknowledge that companies incur additional costs when accounting for the time value of money or when assessing whether the time value of money is significant.*

*Members supporting this view are aware that the suggested criteria could result in the effects of the time value of money not being reflected, even though the effect is significant. However, these members do not consider it to be possible to provide criteria for a practical expedient where this would not be the case, and they think a practical expedient is necessary as requiring entities to assess the effect of the time value of money for all transactions would be too costly compared with the resulting benefits.*

(b) *Other members think that an entity should reflect the time value of money whenever the effect is likely to be significant. However, these members consider it probable that without an explicit exemption, some enforcers and/or auditors will require an entity to calculate the time value of money for the purpose of proving that the effect is insignificant for the contract. These members do not consider this to be cost/benefit efficient. They think it should be possible, in most cases, to assess the significance of the effect by applying less precise methods of assessments. These members think that this could be reflected by including a practical expedient that could be used unless circumstances indicate that the time value of money could be significant. They therefore support the use of the practical expedient but think it should be limited to situations where there are no indications of the time value of money being significant for the contract.*

(c) *Finally, some members think that the practical expedient should be removed. These members think that the time value of money should be reflected in all cases where it would be significant to the contract, and note that the effect can be significant in cases where the proposed practical expedient can be applied. They agree with other members that an entity in most cases would not have to calculate the time value of money to assess whether it is significant, but do not consider it necessary to state or reflect this in the guidance.*

*13 As EFRAG members are split on the issue, a question to constituents is included below. EFRAG notes that the issue does not affect the timing of revenue, but the allocation of amounts between financial income/expenses and revenue.*

***EFRAG's view***

**EFRAG thinks it should be clarified how to allocate different payments to various transfers of promised goods or services when accounting for the time value of money.**

14 EFRAG understands that the IASB's intention is that time value of money should be considered on the net contract asset or liability (that is the payments should be allocated to the various transfers on a FIFO basis), but we do not think this appears clearly from the ED. We think clarification on this issue is needed as, for example, payments in advance and in arrears related to a construction contract, that is satisfied continuously, can be allocated in many different ways over the construction period.

**Question to constituents**

15 Do you think a practical expedient regarding the time value of money should be included in the ED (see paragraphs 10 - 13 above)? If so, what should be included in its scope?

**Offsetting contract assets and advances received**

***Notes for EFRAG's constituents***

*16 According to paragraph 104 of the ED, an entity shall present a contract in the in the statement of financial position as a contract liability, a contract asset, or a receivable depending on the relationship between the entity's performance and the customer's payment.*

*17 Paragraph BC235 of the ED states that the IASB proposes that the remaining rights and performance obligations in a contract form a single unit of account that should be accounted for, and presented, on a net basis as either a contract liability or a contract asset. The IASB further notes that the rights and obligations in a contract with a customer are interdependent – the right to receive consideration from a customer is dependent on the entity's performance and, similarly, the entity will perform only as long as the customer continues to pay. The IASB therefore decided that these interdependencies are best reflected by presenting the remaining rights and obligation net in the statement of financial position.*

*18 According to paragraphs BC236 and BC237 of the ED, the IASB considered whether the rights and performance obligations in contracts that are subject to the legal remedy of specific performance should be presented on a gross basis, i.e. as separate assets and liabilities. The IASB observed that in the event of a breach, such contracts require the entity and the customer to perform as specified in the contract. Therefore, unlike most contracts that can be settled net, specific performance contracts would generally result in a two-way flow of resources between the customer and the entity. The contracts are akin to those financial contracts that are settled by physical delivery rather than by a net cash payment and for which the units of account are the individual assets and liabilities arising from the contractual rights and obligations.*

*19 However, the IASB decided against making any exception for specific performance contracts, because the remedy of specific performance is relatively rare and is not available in all jurisdictions. In addition, it is only one of a number of possible remedies that could be awarded by a court if legal action were taken for breach of contract. Therefore, basing the accounting on a determination of what would happen in that event would be both counterintuitive (i.e. entities do not enter into contracts with the expectation that they will be breached) and difficult (i.e. an entity would need to determine at contract inception what remedy would be awarded by the court if litigation were to take place in the future).*

*20 According to IAS 1 an entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an IFRS.*

*21 IAS 32* Financial Instruments: Presentation *specifies in paragraph 42 when a financial asset can be offset with a financial liability. According to the paragraph a financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:*

(a) *Currently has a legally enforceable right to set off the recognised amounts; and*

(b) *Intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.*

***EFRAG's view***

**EFRAG disagrees that the remaining rights and performance obligations in a contract should always be presented on a net basis.**

22 Paragraphs 104 and BC235 to BC237 of the ED explain that the remaining rights and performance obligations in a contract shall be presented on a net basis, as the interdependencies are best reflected by presenting the remaining rights and obligations net in the statement of financial position.

23 EFRAG disagrees and thinks that offsetting is only appropriate in cases where an entity has a legal right and intention to offset advances received against any assets recognised as a result of a transfer of goods or services. Offsetting in other cases could, in our view, result in financial statements not presenting an entity's liabilities (and assets) appropriately.

**Right of return**

***Notes for EFRAG's constituents***

*24 Appendix B – Application guidance of the ED provides the following guidance on:*

(a) *sale with a right of return (paragraphs B2 – B9);*

(b) *repurchase agreements (put options) (paragraphs B43 – B48);*

(c) *customer acceptance (paragraphs B55 – B58).*

***EFRAG's view***

**EFRAG is concerned that (1) it is difficult to distinguish between sale with a right of return; customer acceptance and repurchase agreements and (2) the guidance will result in economically similar transactions will be accounted for differently.**

25 EFRAG notes that the Application Guidance identifies three situations in which the customer has not irrevocably taken control of assets provided by the entity:

(a) sales with a right of return;

(b) sales subject to customer acceptance; and

(c) repurchase agreements (put options).

26 The ED proposes different guidance for each of these three situations. It is therefore important whether a contractual clause is considered to be:

(a) a right of return, which means that if the entity has experience with similar contracts, revenue should be recognised when the good is transferred to the

customer, but the measurement should reflect the value of the goods the entity expects to be returned, based on its experience; or

(b) a customer acceptance clause, which means the entity cannot recognise any revenue until either the customer accepts the product or the trial period lapses (see paragraph B58 of the ED);

(c) a put option, in which case the contract should be accounted for as a lease, provided the entity has an unconditional obligation to repurchase the asset at a price that is lower than the original selling price and the customer has significant incentive to exercise the option.

27 EFRAG is concerned that:

(a) it may be difficult in many cases to determine whether a contract includes a customer acceptance clause, a return right or a put option. For example, it is not clear whether goods order over the Internet are subject to customer acceptance or a right of return if the customer can deliver the product back and not be obliged to pay the consideration; and

(b) economically similar transactions will be accounted for differently. EFRAG believes that from an economical point of view there is often no difference between an acceptance clause and a return right.

28 EFRAG has considered paragraph B58 of the Application Guidance. From this paragraph it appears as if payment terms matter when distinguishing a return right from a customer acceptance clause. That is, if the customer is not obliged to pay the consideration before the trial period lapses, or the customer accepts the good, the contract includes an acceptance clause and not a return right. However, in cases where acceptance clauses and return rights are included in contracts, EFRAG does not think this distinction is operational as it is difficult to distinguish payment of the consideration from payment of a deposit that will be returned if the asset is not accepted or is returned. Accordingly, this guidance will not always be helpful when assessing whether a contract includes an acceptance clause or a return right. EFRAG therefore considers it necessary that the IASB addresses the operationality of the proposals.

**Questions to constituents**

29 Are you concerned that in practice it will often be difficult to distinguish between the different situations listed in paragraph 25 above where a customer has not irrevocably taken control of assets provided by the entity?

30 Do you think the three situations listed in paragraph 25 above differ economically? If so, how and in what circumstances would it be important to distinguish between the three circumstances?

31 Do you think there are situations where a customer has a significant economic incentive in exercising a return right, but the transaction should not be accounted for as a lease?

32 How do you think the three situations listed in paragraph 25 above should be accounted for?

**Disclosures**

***Notes for EFRAG's constituents***

*33 The objective of the revenue recognition disclosures is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have substantially different characteristics.*

*34 The ED requires disclosures on:*

(a) *contracts with customers, including:*

(i) *a disaggregation of revenue for the period;*

(ii) *a reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities;*

(iii) *information about the entity's performance obligations, including additional information about any onerous performance obligations.*

(b) *significant judgements in the application of the requirements, including:*

(i) *the timing of satisfaction of performance obligations; and*

(ii) *the transaction price and the amounts allocated to performance obligations.*

(c) *Any assets recognised from the costs to obtain or fulfil a contract with a customer in accordance with the guidance provided in the ED.*

***EFRAG's view***

**EFRAG agrees with the objective of the proposed disclosure requirements and thinks that most of the disclosure requirements will help in meeting the objective. However, we are concerned about the costs of providing the information and question whether the benefits of providing a reconciliation of contract balances exceed the costs.**

35 EFRAG agrees with the disclosure objective in the ED and that the proposed disclosures provide information that is helpful in meeting the objective. We are, however, concerned about the costs of providing the information.

**Question to constituents**

36 EFRAG would welcome comments regarding the usefulness and the cost of preparing the disclosures required by the ED and an assessment of whether an acceptable trade-off between costs and benefits is met.

**Early application and effective date**

***Notes for EFRAG's constituents***

*37 While the IASB has not yet decided on the effective date of the resulting standard, it has agreed that the effective date would not be earlier than 1 January 2015. Earlier application will be permitted. If an entity applies the resulting IFRS earlier, it shall disclose that fact.*

***EFRAG's view***

**EFRAG thinks that the effective date should be three years from the publication of the standard.**

38 EFRAG thinks that the effective date should not be earlier than 1 January following three years from the publication of the standard, for the following reasons:

(a) the standard has pervasive effect on the financial statements and would need to be applied largely retrospectively;

(b) collecting comparative information under the new standard would often require entities to facts and make the required judgements at the time that the underlying transactions occur, as there may not be a straightforward way to convert information from the old to the new standard; and

(c) in many jurisdictions, the new standard would need to be translated and endorsed or may require amendments to the legal or tax framework.

**Question to constituents**

39 EFRAG has discussed whether early adoption should be allowed for existing IFRS reporters. Permitting early adoption by existing IFRS reporters would reduce comparability between companies, but it would allow them to move to the improved standard sooner.

*40* Do you think early application of the new standard on revenue recognition should be allowed for entities already reporting under IFRS*?*

**Other concerns**

***Notes for EFRAG's constituents***

*41 In paragraph IN36 of the ED, the IASB invites individuals and organisations to comment on whether the proposed requirements are clear and can be applied in a way that effectively communicates to users of financial statements the economic substance of an entity's contracts with customers.*

***EFRAG's view***

52 In relation to the clarity of the proposals, EFRAG understands that some consider the boundaries of a contract to be insufficiently specified in the ED. That is, it is considered unclear how long the contract period is when the customer and the entity have different termination and extension options.

53 If, for example, an entity can terminate a contract at any point in time, but the customer is bound by the contract for two years, should:

(a) the duration of the contract for revenue recognition purposes be assumed to be two years?

(b) the duration of the contract for revenue recognition purposes be assumed to be the notification period that should be considered if the entity wants to terminate the contract? or

(c) the contract be considered outside the scope of the standard because the entity cannot be said to be committed to perform all of its obligations?

54 Some are also uncertain whether it would make any difference if the entity formally had an extension option instead of a termination option.

**Questions to constituents**

55 Do you share the concern expressed by some in relation to the boundaries of a contract (see paragraphs 52 to 54 above)?

56 Do you have additional concerns in relation to the clarity of the requirements and to whether the proposed requirements can be applied in a way that effectively communicates to users of financial statements the economic substance of an entity's contracts with customers? If so, could you describe in details the issue and the reason for your concern?

## APPENDIX 3

### Field-testing activities

1 In addition to issuing its draft comment letter for comments, EFRAG is performing field-testing activities of the proposals in cooperation with European National Standard Setters and in coordination with the IASB. The field-testing activities cover both issues related to the preparation and use of financial statements.

2 EFRAG's final comment letter to the IASB on the ED will incorporate the results of field-tests completed before finalisation of the comment letter. EFRAG therefore encourages preparers and users to finalise their field-tests before 13 March 2012. The results of field-tests completed after finalisation of the final comment letter will be communicated to the IASB separately.

3 The purpose of the field-testing activities related to the preparation of financial statements is to identify requirements that need to be (re-)considered when finalising the standard.

4 The activities should thus will provide evidence on:

(a) the clarity of the guidance provided in the ED,

(b) the impact on financial statements of the proposed requirements, and

(c) costs and benefits of the proposed requirements.

5 As the purpose of the activities is to identify issues, the results of the activities will neither reflect the general costs and benefits of the proposals nor the general impact on financial statements.

6 The field-testing activities related to the preparation of financial statements are carried out by asking preparers to apply the proposed requirements on some of their contracts with customers under various scenarios. All preparers volunteering to participate in the test when EFRAG called for companies to participate in August and September 2011 are included in the test. The selected contracts are mainly related to the following industries: telecommunications, software, pharmaceuticals, industries operating under long-term contracts, and utilities.

7 These are the industries EFRAG expects will be most significantly affected by the proposals. The Italian Standard Setter (OIC) is in cooperation with EFRAG conducting an extensive field-test in Italy, covering also industries other than those listed above.

8 The purpose of the field-testing activities related to the use of financial statements is to assess whether the proposals will result in more useful information. These field-testing activities will be carried out by asking financial statement users to assess whether they think the proposed requirements results more useful information for selected transactions compared with current requirements.