

# Rådet **för** **finansiell rapportering**

The Swedish Financial Reporting Board

RFR-rs 2012:03

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

Dear Sirs,

## **Re: IASB Exposure Draft ED/2011/6 Revenue from Contracts with Customers**

The Swedish Financial Reporting Board is responding to your invitation to comment on the Exposure Draft Revenue from Contracts with Customers.

The exposure draft proposes that revenue should be recognized only when control of goods and services is transferred to the customer. We do not believe this is the correct starting point for revenue recognition and we do not support such a model. On the contrary, we believe that revenue should reflect the performance of the entity. One important aspect in this regard is to consider how the management of the company evaluates its business activities and assesses its performance. Such evaluations and assessments usually are based on performance of the entity. Accordingly, we believe there will be much more alignment between the revenue recognition model and the business model of the entity if recognition of revenue is based on performance of the entity.

In addition to our main objection that performance of the entity should govern revenue recognition, we have the following general views:

- The proposed model incorporates a rules-based approach to many situations, for example with regard to conditions for continuous transfer. This is problematic when there are situations not covered by these rules. We think that more field-tests are required in a broad range of industries to ensure that the proposed standard allows for robust applications.
- We oppose basing revenue recognition on the transfer of control, since this means that an analysis of economic conditions is replaced by an analysis of legal conditions. There will be increased incentives for entities to structure contracts to achieve desired accounting outcomes. Financial reports should be aimed at capturing the value creation to customers, not to establish rights and obligations at a specific point in time in case of a dispute.
- We strongly oppose the additional disclosure requirements, which are too extensive, not least for interim reports.



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- We believe that it would have been possible to make the proposed changes compared to current practice at a much lower cost to all concerned parties by amending the present standards, an approach we previously have suggested. The approach taken by the Board has introduced unnecessary uncertainty regarding the implementation of the standard. This is an important learning point for future standard-setting projects.

In addition to our general views, we have a number of detailed comments as outlined below.

## **Transfer of control over time**

Since recognition of revenue is an area of financial reporting, which affects a broad range of entities on many levels of the organization, it is especially important that the standard is based on clear principles. Basing the recognition of revenue on transfer of control and using the difficult concept of continuous transfer has resulted in an unclear structure of the new proposal. Regarding transfer of control over time, the accounting is established by answering a number of questions in three steps, where the answers alternately establish when continuous transfer is at hand and when it is not.

Furthermore, each of the situations aimed at by the questions in the third step (right to payment, simultaneous consumption and need to re-perform) could be seen as exceptions introduced to solve specific issues which have been identified in specific industries. It is difficult to see the link to a common principle, which could be problematical, when there are situations not covered by these rules. Such situations probably already exist, and will without doubt appear in the future. Hence, the new standard does not necessarily improve the accounting quality, and we think that more field tests are required in a broad range of industries to ensure that the proposed standard allows for robust applications. With more detailed rules there are also increased incentives for entities to structure contracts to achieve a desired accounting outcome.

We have previously requested that the IASB should publish illustrations related to continuous transfer to clarify the Board's thinking. We still find the draft incomplete in that respect, in the examples provided it is assumed that the conditions for continuous transfer are fulfilled.

## **Identifying performance obligations within a contract**

The application problems mentioned above will be accentuated by the fact that the way the standard is structured there are two situations where (some) revenue is recognized before the completion of a contract. One is when separate performance obligations are identified and some of these are fulfilled before the full contract has been fulfilled. The other is when control is transferred continuously from a single performance obligation/contract. The distinction between the two situations will not always be clear. In addition, application problems similar to those for performance obligations satisfied over time will occur related to performance obligations satisfied at a single point in time. For example, the concept of relationship ("highly interrelated") has to be further developed. As we understand it, the Board was worried that if the standard was based solely on the identification of distinct goods and services, there was a risk that too

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many separate performance obligations would be reported and introduced this restriction. Since most components in a contract are related in some way, in the absence of a discussion of the concept there is a real risk that an entity will be required to account for a bundle of goods and services as a single performance obligation, thus preventing recognition of revenue reflecting the value creation. We do not think that the further requirement that the bundle of goods is significantly modified or customized solves the problem, since we believe that bundles of goods and services are often customized.

## **Treatment of credit risk**

We agree on the basic premise, that normal credit risk should neither affect the timing nor the amount of revenue recognition. However, we believe that all credit losses should be presented on the same line in the statement of profit and loss. To present credit losses on two different lines is potentially misleading. You would expect that the longer the duration of the contract, the higher the risk of a credit loss, possibly making the amounts significant. Having credit losses on contracts deemed to have a separate finance component accounted for separately could make it more difficult for a user to get a comprehensive view of revenue and credit losses. There is already a timing problem, since a credit loss may well occur and be reported in another period than the corresponding revenue. As to the question whether the credit losses should be presented adjacent to revenue recognition or as an expense further down in the statement of profit and loss, we think this should be left to practice.

## **The time value of money**

In the proposed draft, there are two types of calculations linked to the time value of money: calculations of the end-value of advance payments to get the value of performance obligations at transfer of control and calculations of the present value of an expected payment at transfer of control to get the value of a contract asset. There are problems related to both the interest rate and the amounts and time of transfer. Regarding interest, the standard requires entities to use the rate that would be used in a financing transaction between the entity and its customer that did not involve the provision of goods and services. Since this is something they do not do, this would involve estimates. Regarding amounts and time of transfer, we do not think that it is clear how the calculations will be performed when there is transfer over time.

We believe that price and credit terms are highly interrelated and that in many cases the benefits of an allocation of income in terms of revenue and interest does not justify the costs. Consequently, we support robust requirements reducing the need to make such allocations and the number of estimates to be made. We think the calculations should be based on cash flows and a simplified estimate of interest.

## **The application of the “reasonably assured”-criterion on intellectual property licenses**

We agree that an entity should not recognize revenue based on an estimate of the customer’s sales during the full contract period already at the sale of a license. However, we disagree on the way that this outcome is achieved in the proposed standard, i.e. by introducing a rules-based prohibition. The way we understand this

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prohibition, is that otherwise an entity might recognize revenue based on an estimate of the customer's sales during the full contract period already at the sale of the license, founded on the criterion that the customer has obtained control of the license. If that is the case, we think that is another weakness of having revenue recognition founded on transfer of control.

## **The scope of the onerous test**

The standard states that onerous tests should be made at the performance obligation level. On one hand, this is consistent with having separate performance obligations as the unit of account. On the other hand, identifying a liability for an onerous performance obligation when the contract as a whole is profitable, would not be consistent with the definition of a liability. Choosing between two imperfect alternatives, we believe that the onerous test should be carried out at contract level, since we think that it would be counter-intuitive to many people to recognize a loss on a specific performance obligation when the contract as a whole is profitable. If the recognition of a separate performance obligation would result in a loss, while the contract is still profitable, we think there should be zero profit-recognition on that separate performance obligation.

We believe that this is an area, where there is a too rules-based approach. To begin with the Board states that onerous tests are necessary, but then it is argued that entities sometimes do not have to make such tests for pragmatic reasons. A more principles-based approach would have required onerous tests to be made regardless of whether an obligation is satisfied over time or at a point in time and regardless of the time span from contract inception to the expected satisfaction of the obligation. 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.

## **Allocating discounts**

We believe that any discounts should be allocated to individual performance obligations on the basis of their margins, since this would better represent the commercial considerations made when entering into a contract.

## **Disclosure requirements**

We strongly oppose the additional disclosure requirements, which are extensive, not least for interim reports. We simply do not see the benefits from all of these disclosures.

We do not consider the list of specific disclosure requirements proposed for interim reports to be in accordance with the principles underlying IAS 34. We believe 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.

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The reconciliation of opening and closing balances is not very useful. The usefulness of financial statement information is primarily a function of the quality of the information of the assets and liabilities in the reports. If the quality of this information is low, this could not be compensated by disclosure of reconciliations from opening to closing balance. Regarding the increased requirements for disclosure of expected revenue in future periods we are concerned by the reliability of such information. For example, we do not think that information about the estimated effects of orders on future revenue will be sufficiently reliable, since contracts are often renegotiated when conditions change (regardless if there are renegotiation clauses or not).

## **Effective date**

We think that the effective date of the standard should not be earlier than January 1, following three years from the publication of the standard. We agree on the proposal of retrospective application. We support that earlier application should be allowed.

We also note the proposed standard's connection to the other standards on insurance, leasing and financial instruments, which the Board is currently working on. We think that the finalization of these standards has to be considered when setting the effective date for the proposed standard on revenue from contracts with customers.

## **Other remarks**

We believe that it would have been possible to make the desired changes compared to current practice at a much lower cost to all concerned parties by amending the present standards, an approach we previously have suggested. The approach chosen by the Board has introduced unnecessary uncertainty regarding the implementation of the standard.

We also observe that during the whole process, new indicators of control have been introduced replacing previous ones. Although we appreciate that the IASB is open to changes, we think that the repeated changes is a result of an inherent absence of robust criteria, which indicates a weakness of the Board's approach.

We have not seen any discussion about transactions in foreign currency although this presumably would have bearing on the issue of contract assets discussed above (and also on other issues). For example, assume a transaction price of 100 in Foreign Currency Units (FCU). At contract inception FCU 1 equals 5 Domestic Currency Units (DCU) and the transaction price equals the performance obligation. Both contract asset and contract liability will be DCU 500. Further assume that immediately after the inception of the contract DCU is weakened so that FCU 1 = DCU 6. The economic consequence is that the asset increases in value to DCU 600. If it's further assumed that the cost to fulfill the performance obligations will be incurred in DCU, the economic consequences of that are more difficult to establish (some would argue that economically the obligation doesn't change). Foreign currency changes will normally affect net contract assets and contract liabilities. We think that the Board should clarify its view on the effect of foreign currency changes on reported contract assets and other aspects of revenue recognition.

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If you have any questions concerning our comments please address our Executive member Claes Janzon by e-mail to: [claes.janzon@radetforfinansiellrapportering.se](mailto:claes.janzon@radetforfinansiellrapportering.se)

Stockholm, 16 March 2012

Yours sincerely



Anders Ullberg  
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