

International Accounting Standards Board  
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Submitted by email to [commentletters@iasb.org](mailto:commentletters@iasb.org))

**Discussion Paper: Preliminary Views on Revenue Recognition in Contracts with Customers**

Grant Thornton International Ltd and its US member firm, Grant Thornton LLP, are pleased to comment on the International Accounting Standards Board's (the IASB) and the Financial Accounting Standards Board's (the FASB) joint Discussion Paper: *Preliminary Views on Revenue Recognition in Contracts with Customers* (the DP). We have considered the DP, as well as the accompanying illustrations and examples.

We support the Boards' reasons for undertaking a comprehensive review of revenue recognition principles. The case for change has been well articulated by the Boards and we welcome the development of a converged solution.

As the Boards have acknowledged, the proposals in the DP do not yet include views on many issues. We believe a number of these outstanding issues are significant and that the proposed model will need to be re-evaluated once it is fully developed. However, at this stage we consider that the basic 'building blocks' of the model provide a suitable starting point for discussion. In particular:

- although revenue is not explicitly defined, the focus on the contract with the customer helps to delineate economic benefits presented in the revenue line from other economic benefits presented elsewhere in the financial statements;
- using a transfer of control model to identify performance under the contract is clearer than a mixed control and risks/rewards model. This should improve consistency of decisions about the timing of revenue recognition; and
- a relatively simple measurement and recognition model is preferable to achieve greater consistency of application with less risk of error while providing decision-useful information for the large majority of transactions within the scope.

We do have some concerns with the proposed model. Our more significant concerns (outlined in more detail in our response to question 2) are that:

- we are not convinced that the model is sufficiently developed to identify a clear principle for the recognition of transfer of services, particularly 'stand-ready' obligations;

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- similarly, the boundary between 'rights-of-use' contracts within the scope of this project and those within the scope of the leasing project is unclear;
- for long-term contracts with no continuous transfer, we believe there will be a substantial loss of decision-useful information.

We outline a number of other concerns in our responses to the detailed questions in the appendix to this letter. However, we believe that most of these can be addressed by developing more application guidance or better articulating some of the concepts.

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If you have any questions on our response, or wish us to amplify our comments, please contact our Executive Director of International Financial Reporting, Andrew Watchman (andrew.watchman@gtuk.com or + 44 207 391 9510) on behalf of Grant Thornton International Ltd or Gary Illiano, National Partner-in-Charge of International and Domestic Accounting (Gary.Illiano@gt.com or +1 212 542-9830) on behalf of Grant Thornton LLP.

Yours sincerely,



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## Appendix: Responses to Invitation to Comment questions

### Chapter 2: A contract-based revenue recognition principle

**1. Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not?**

**If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?**

We agree that a single revenue recognition principle is desirable and that the net position in the contract is the appropriate unit of account for recognition and measurement purposes. This works well for the statement of financial position.

We note that the proposed model bases the timing of revenue recognition on the satisfaction of 'performance obligations' which in turn depends on transferring assets to the customer. The desire to frame the definition of performance obligations around the asset transference is problematic when dealing with services. Moreover, the DP does not clearly articulate what asset is transferred in 'stand-ready' obligations or in 'continuous transfer' situations. (See in particular our responses to questions 4 and 8 below.)

**2. Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why.**

**What alternative principle do you think is more useful in those examples?**

The DP already highlights three types of contract in relation to which the Boards are currently questioning the usefulness of the proposed model: financial instruments in the scope of IAS 39 or SFAS 133; insurance contracts in the scope of IFRS 4 or SFAS 60; and leases in the scope of IAS 17 or SFAS 13 (DP.S11). We agree that these types of contracts should be considered separately. However, opportunities to achieve greater consistency in accounting for different types of customer contracts should be evaluated as far as is practicable.

The DP does not articulate a clear case for where the boundaries should be set between this model and others in development. The contracts addressed in the DP have characteristics that are similar to contracts that are outside the proposed scope. In particular, 'right-of-use' licensing agreements such as those commonly seen in software contracts are similar to arrangements in the scope of the leasing project. Also, 'stand-ready' obligations such as warranty contracts are similar to insurance contracts within the scope of the insurance project. We encourage the Boards to re-examine these scope issues and, to the extent that the various models in development result in differences, to consider which model is most appropriate for these types of contracts.

In addition, we believe that the detailed application of the proposed principle will reduce the decision-usefulness of the information in financial statements on long-term contracts where there is no continuous transfer of control. In such cases the entity will not recognise revenue until final delivery of the good or service, potentially resulting in unhelpful volatility in reported earnings and activity levels.

Consequently, the Boards need to balance two competing principles: the 'transfer of control' principle described in the DP and the principle of 'faithful representation' of the economic position and performance of the entity set out in the IASB's and FASB's joint project Exposure Draft: *Conceptual Framework - Phase A: Objectives and Qualitative Characteristics*. The DP does not clearly identify what information users require to assist in their assessment of entities with such long-term contracts. More investigation is needed as to whether this is an area where the need for relevant information requires a departure from the basic model. If so, clear guidance will be needed to help preparers identify what criteria need to be considered to help identify which contracts could or should recognise revenue as activities progress rather than as control is transferred. This may be the case, for example, where the contract grants the supplier with a right to consideration for the value of work completed to date.

The somewhat legalistic approach currently proposed creates the risk that long-term contracts with substantially the same terms may result in very different accounting treatment because of some minor wording differences that create non-substantive legal clauses (see also our response to question 8).

**3. Do you agree with the boards' definition of a contract? Why or why not?**

**Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.**

The proposed definition of a contract appears reasonable. It does not obviously rely on specific contract law in any particular jurisdiction but it will rely on judgement in determining what is enforceable. However, the definition of a contract in IAS 32.13 is worded differently, which may create interpretational difficulties. Although DP2.12-13 note that the DP definition is considered to be consistent with IAS 32 (and the general definition commonly used in the US) we believe that common wording should be used.

In some circumstances judgement will be needed to decide when a contract comes into being. It is sometimes the case in professional services that substantial work is undertaken before signing an engagement letter. Application guidance will be needed to promote consistency in identifying the factors that indicate when a contract is sufficiently defined to recognise revenue under the model (see also our response to question 11).

**Chapter 3: Performance obligations**

**4. Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not?**

**If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.**

We agree that defining performance obligations as a promise to transfer a good or service is helpful. However, the use of the word 'asset' causes problems in some cases. It seems that the Boards are attempting to force asset/liability language into the model rather than defining a clear principle that will drive the application in practice. We acknowledge that the concept of a service being described as an asset is already in existing literature (DP 3.13). We also agree that the definition should work well for the majority of contracts involving physical goods and simple discrete services related to a physical item such as cleaning services.

However, we envisage a number of application difficulties when looking at continuous service obligations and stand-ready obligations. For example, if the contract provides for consulting services culminating in delivery of a report, is the contract for delivery of services over time or for delivery of the report (good)? Application or implementation guidance covering a range of different types of contract will be needed to help identify and apply any generic principle.

The need for a clearer principle, or additional guidance on the general principle, is evident in the DP's approach to revenue recognition for stand-ready contracts. For example:

- warranty obligation revenue is recognised on a time basis (Appendix A example 3);
- sales incentive revenue is recognised **if and when** the incentive award is redeemed, but there is no indication of what to do with the consideration allocated to the parts that are not ultimately transferred (DP3.33);
- the DP does not indicate when right of return revenue is recognised (DP3.34-42).

We question whether the passage of time represents the transfer of an asset. Also, if revenue is not recognised unless and until a customer calls for action under the stand-ready clause, what asset is transferred if the customer's right expires unused?

We also find the proposed model unclear in relation to arrangements involving customer activation or access. For example, a cable company must activate the service for the customer as well as providing the monthly service over the term. In the absence of more specific guidance, we believe that inconsistency will arise in assessing whether activation involves transferring an asset to the customer.

**5. Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not?**

**If not, what principle would you specify for separating performance obligations?**

We agree that the entity should recognise separate performance obligations based on the timing of transfer of promised deliverables to the customer. However, as noted above, in the absence of a tangible asset or physical service activity that can be identified as the 'asset' transferred, it will in some cases be difficult to identify when the obligation is satisfied.

**6. Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?**

We agree that the delivery of the good subject to the right to return clause transfers the control of that good to the customer. Accordingly we also agree that the proposed model would result in recognition of the revenue allocated to that component of the contract on initial sale to the customer. We do not agree with the 'failed sale' model for the reasons given in the DP.

We also agree that that the promised right of return is an enforceable term of the contract deliverable at a different time and so some revenue should be allocated to this component. However, as noted in our response to question 4 above, we are not clear when the revenue so allocated to the return service is recognised in the absence of greater clarity as to the 'asset' that is transferred to the customer in a 'stand-ready' obligation.

It may be more useful and persuasive to describe the return obligation as a written option liability rather than a performance obligation. Guidance on the appropriate accounting treatment of this option will still be needed.

On a point of detail, although the identification of additional consideration may be a useful indicator that a right of return is an additional service (DP3.37) we do not believe this should be an essential criterion.

**7. Do you think that sales incentives (eg discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?**

Yes we agree that sales incentives give rise to performance obligations for the reasons given in the DP. This concept is consistent with the current interpretation IFRIC 13 *Customer Loyalty Programmes*.

As noted in our response to question 4 above, DP3.33 indicates revenue is only recognised if and when the incentive is redeemed. Guidance is needed as to how to deal with lapses and changes in lapse expectations.

Application guidance to clarify the treatment of volume rebates and 'cash-back' incentives would also be helpful.

Chapter 4: Satisfaction of performance obligations

**8. Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not?**

**If not, please suggest an alternative for determining when a promised good or service is transferred.**

We agree with the proposal to concentrate on transfer of control. This is not only more consistent with the Boards' relevant Frameworks but should also be more straightforward to apply compared to the existing mixed model. However, it will be important to define control carefully. This term currently has a number of different meanings in different parts of IFRS. For example, in IAS 18 control is not defined but is perhaps associated with managerial involvement; in IAS 27 the control concept is based on power to take decisions and in IAS 39 on the practical ability to sell a transferred asset.

In the DP, the Toolco examples at 4.11 et seq take a 'legally enforceable rights' view of control. We accept the Boards' view (DP4.18-19) that where differences in legal rights have an economic effect, the contracts should be accounted for differently. However, we are concerned that some contracts may be treated differently because of different wording that in practice has little or no substantive impact (other than perhaps on a winding up). For example, a customer might have a legal entitlement to take the work to date and change supplier, but it will very often be commercially unattractive or prohibitive to do so (especially if there is a cancellation penalty).

As noted above, we believe the transfer principle is underdeveloped for application to situations where there is no tangible asset or physical service. Clear application guidance across a broader range of services is needed, especially stand-ready and complex professional services such as those involving legal cases, consulting, audit and accounting services. (The payment terms indicator for consultancy services in DP4.37 is insufficient to identify a clear underlying principle.)

**9. The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.**

Linking the timing of revenue recognition to satisfaction of performance obligations is a suitable approach for the majority of contracts. As noted in our response to question 2, we believe that the level of decision-useful information is likely to reduce substantially under this model for long-term contracts where there is no continuous transfer.

As noted in our response to question 4, we cannot find a clear principle to help us identify what asset is transferred in a variety of stand-ready contracts, nor can we identify a consistent method of recognising revenue under these contracts in the DP. We are therefore unclear as to what decision-useful information the Boards believe may be relevant to such contracts.

Chapter 5: Measurement of performance obligations

**10. In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.**

- a. **Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?**
- b. **Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?**
- c. **Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not?**

**If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.**

- d. Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not?**

**If so, please provide examples and describe the measurement approach you would use.**

- a. Yes, we agree that initial measurement should be based on transaction price. The DP does not consider variable or contingent fee contracts but we suggest that the initial measurement should be based on a best-estimate of the expected value.
- b. Yes, remeasuring an onerous contract to the entity's expected cost of satisfying the performance obligation provides a relatively simple principle that is likely to provide decision-useful information in most cases. Its simplicity is likely to result in more consistent application.
- c. We accept that the proposed approach may create greater volatility in the margins recognised for the satisfaction of different performance obligations if there is a higher level of variability in outcomes. However, we support the development of a simplified single model that is suitable for most contracts. Additional disclosure will help to identify those contract for which the added volatility is material to the users understanding of the financial statements.
- d. We have not identified any performance obligations that should be subject to a different measurement approach.

- 11. The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (eg selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.**

- a. **Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?**
- b. **In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.**
  - a. Yes we agree. This reflects the value that the customer attaches to those services.
  - b. In some industries, this requirement will be controversial because these costs may be substantial (and so should be disclosed) but there is no obvious conceptual basis for capitalising them.

However, we suggest that application or implementation guidance is provided to help identify when and how an asset could be recognised. For example, development costs are commonly incurred, perhaps on designs or blue-prints, that are used on a specific, probable future contract. Such a resource might also be modified or used in other proposals or bids. In some cases, we believe the conditions for recognising an asset under IAS 38 *Intangible Assets* may be met. Another example may arise in major infrastructure type contracts for which there is often a lengthy and costly bidding process. A bidder may have a strong expectation of success when they achieve short-list or preferred bidder status. At this stage the potential customer may indemnify the bidder for the further bidding costs. It would be reasonable to recognise these indemnified costs as an asset but would this represent a revenue contract; an indemnification asset (similar to those identified in IFRS 3R *Business Combinations*); or some other asset?

**12. Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not?**

**If not, on what basis would you allocate the transaction price?**

We agree with this principle. However, we believe that the expression of the principle needs some refinement or further guidance. For example, the stand-alone price of a mandatory warranty attached to a good could be interpreted to be the stand-alone price of the underlying repair/replacement service without adjustment for the probability of the service being needed.

**13. Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not?**

**When, if ever, should the use of estimates be constrained?**

Yes. In practice, estimates can be made using internal pricing information. Even if the entity does not actually sell the different elements separately, a reasonable margin can be allocated to internal costing information.

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