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International Accounting Standards Board
30 Cannon Street
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Comments on the Discussion Paper of *Preliminary Views on Revenue Recognition in Contracts with Customers*

To the Board Members:

The Japanese Institute of Certified Public Accountants appreciates the continued efforts of the International Accounting Standard Board (IASB) on the revenue recognition project and welcomes the opportunity to comment on the discussion paper of *Preliminary Views on Revenue Recognition in Contracts with Customers*.

JICPA is in favor of developing a single revenue recognition model by the IASB. We hereby submit our comments on the proposals with which we disagree or have questions or concerns in response to the "Questions for respondents" in the Discussion Paper, primarily in view of verifiability and consistency in practice.

1. Analysis of Difference with Present Practice

The Discussion Paper states that there would basically be little changes in the present practice for most transactions by applying the proposed revenue recognition model. However, since the Discussion Paper does not provide sufficient examples for various transactions by applying the proposed model, it is not clear to understand the extent and

type of transactions that would or would not give rise to any differences.

2. Accounting Treatment where Vagueness of Contracts exists as Customary Business Practice

The Discussion Paper defines a contract as an agreement between two or more parties that creates enforceable obligations, irrespective of explicit or implicit one, and then an entity recognizes revenue when the contract asset increases or the contract liability decreases or when some combination of both arises from the contract with the customer by focusing on the contractual agreement.

On the other hand, as seen in some countries and regions including Japan, there are cases in which matters not explicitly stated in the contract are regarded as implicit knowledge in customary business practice, and cases in which matters newly agreed upon by and between entities after initial contract inception are not expressly stated in the form of memorandums. In such cases where the matters agreed upon by the parties are not explicitly stated, it is unclear whether it is possible to effectively determine the matters that have actually been agreed upon by the parties at the time of concluding the contract with a customer. Consequently, there may be no alternative but to recognize revenue and measure performance obligations under a contract based on the formal terms of the contract in writing.

For this reason, it should be considered certain cases presenting specific requirements that the contract may be deemed an agreement between two or more parties that creates enforceable obligations even if the matters agreed upon by the parties are not explicitly stated.

3. Vagueness of Timing of Transfer of Control

The idea of recognizing revenue at the time of transfer of control, that of satisfaction of performance obligations, is understandable from the point of view of bringing a certain level of discipline to the existing model. However, as the cases considered in the Discussion Paper are too few in number, it is unclear whether the vagueness of the earnings process—which is deemed a deficiency in the current approach—could be resolved as a result of adopting the model presented in the Discussion Paper, especially with respect to transactions involving multiple components that are difficult to determine in practice.

4. Measurement of Rights

Paragraph 5.5 of the Discussion Paper states: "Because the boards have not yet expressed a preliminary view on the measurement of rights, this discussion paper ignores the time value of money and assumes that the consideration is fixed and paid in cash."

It states that it is possible to recognize revenue even if the risks and the rewards of ownership are not transferred in the stage where performance obligations are satisfied and control is transferred (paragraph 4.10 and thereafter). However, it may be necessary to consider whether it would be appropriate to assume that the consideration is fixed and paid in cash when recognizing revenue, if, for example, there are doubts over the collectability of the payment in cash.

Therefore, when conducting studies on the measurement of rights in the future, it should be carefully considered how the time value of money and any uncertainties in the amount and collectability of consideration would be reflected in the measurement of rights, and whether or not they would relate to revenue recognition.

5. Use of Estimates in Revenue Recognition

The Discussion Paper allows the use of estimates in revenue recognition for delivered items; this is similar to the current IAS 18, which does not limit the use of estimates, but different from SOP 97-2, which requires deferral of revenue if there is no vendor-specific objective evidence (VSOE) in software revenue recognition, and EITF Issue No.00-21, which requires objective and reliable evidence of selling prices for undelivered items as a revenue recognition requirement of delivered items in sales contracts of multiple deliverables. The boards suggested that estimates be based on a stand-alone selling price and mentioned the *expected cost plus a margin approach* and *adjusted market assessment approach* as possibilities, but have not drawn any conclusions.

However, reliable measurement of the amount of revenue is deemed the most important prerequisite in revenue recognition; therefore, the use of estimates should be limited for certain cases.

The following is our response to the items in 'invitation to comment' with which we disagree or have questions or concerns.

CHAPTER 3

Question 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.

Comment:

Paragraph 2.12 of the Discussion Paper states the definition of a contract in IAS 32, and paragraph 2.13 of the Paper presents the definition commonly used in the United States, both of which require the creation of obligations enforceable by law.

Paragraph 3.1 also states that performance obligations are obligations that arise from a contract with a customer. Therefore, performance obligations under the definition proposed in paragraph 3.2 are also deemed to require the existence of enforceability by law.

On the other hand, paragraph 3.6 states that, in cases where an entity establishes a practice of providing particular goods or services, "even if neither the contract nor the law explicitly requires such a service, the entity by its customary business practice may have implicitly or constructively created an obligation that would be enforceable." Paragraph 3.7 explains that such customary business practice is also a performance obligation.

As there may be cases in which the provision of goods or services by customary business practice is not legally enforceable, if such customary business practice is deemed a performance obligation, inconsistencies might arise between the definitions and the scope of performance obligations to be identified in practice might become unclear. Put differently, in cases where an entity provides goods or services solely in accordance with its own policies on the back of the customary business practice of the industry, it may be difficult to objectively prove the enforceability of such practice in many cases.

Furthermore, consistent judgments might not be made in regards to whether or not a transaction performed based on a business model with a short history had been

established as a customary practice.

Therefore, even if goods or services are provided as a customary business practice, in order for this to be construed as the existence of performance obligations, it may be necessary to stipulate that it entails some kind of legal enforceability, including the application of the doctrine of estoppels.

Question 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?

Comment:

In accounting theory, the obligation to accept a returned good and refund the customer's consideration is regarded as one of the performance obligations.

The obligation to accept a returned good is a term of the contract to accept a sold good upon the customer's request. A stand ready obligation that is separate from the provision of the sold good is deemed to be borne throughout the returnable period. In other words, the promise made with the customer to accept a returned good is included as a component of the "promise in a contract with a customer to transfer a good (service) to that customer"; therefore, the definition of performance obligations in paragraph 3.2 is deemed to be fulfilled.

Regardless of whether the good is sold with or without a right of return, the control of the good is deemed to have been transferred to the customer at the time of delivery (refer to paragraph 4.12). Accordingly, even if the obligation to accept a returned good is interpreted as a performance obligation, revenue for the sale of the good is recognized at the time of transfer of control, so the practice is expected to be consistent. That said, it should be carefully considered in the future as to whether or not an entity can reliably estimate the stand-alone selling price for the obligation to accept a returned good and refund the customer's consideration, and how the possibility of exercising the right of return in the future is related to revenue recognition associated with the sale of the good at the time of transfer of control.

Question 7

Do you think that sales incentives (e.g. 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?

Comment:

We believe that not all sales incentives would necessarily give rise to performance obligations.

In the example referred to in paragraph 3.27, at the time of selling a music player, TuneCo and SongCo certainly have the obligation to sell music at a discount to a customer for future music download purchases. However, at the time of selling the music player, the customer has not entered into a contract to purchase music downloads, meaning that without such future contract, no such obligation to sell music at a discount would consequently arise.

Therefore, in regards to how to interpret an incentive programme in the form of a discount for future sales, a study should be conducted on the identification of performance obligations by combining the music player sales contract with the future music sales contract, that is not yet concluded at this point in time. Such study should also be conducted in the process of examining issues regarding the combination of contracts in the future.

As described above, an incentive programme that relies on whether or not a specific event arises in the future might not give rise to a performance obligation, depending on the results of analysis of the relationship with such specific event. On the other hand, an incentive programme that provides 'free' goods and services regardless of whether or not a specific event arises in the future is effectively equivalent to selling such goods and services at the same time, in which case the incentive programme is deemed to give rise to a performance obligation.

CHAPTER 4

Question 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.

Comment:

We agree with this proposal in the sense that focusing on the transfer of assets, satisfaction of the performance obligation with the customer, would bring a certain level of discipline and order to the current earnings process approach.

In the Discussion Paper, the time at which a performance obligation is satisfied is interpreted as the time of "transfer of control of an asset (good or service)". With respect to the "transfer of the risks and rewards of owning an asset", the Discussion Paper gives returns (paragraph 4.11) and sale on trial (paragraph 4.14) as examples, and points out that in cases where the risks of ownership are shared by more than one party, discrepancies might arise in the judgment of whether an asset has been transferred to the customer based on the risks and rewards notion. We believe that the basic approach—under which the entity is deemed to have transferred an asset to a customer (and satisfied a performance obligation) when the customer controls the asset—is consistent with the current accounting approach applied to many existing transactions.

On the other hand, the notion of transfer of control itself rests on interpretation in the first place. Even if "risks and rewards of ownership" are rephrased as "transfer of control", it is unclear how the vagueness in the interpretation under the current revenue recognition model will be resolved, as there are concerns in that it is still necessary to interpret the timing at which the asset is transferred to the customer.

These concerns become even stronger in the case of services and an entity's asset used by a third party, such as a customer loyalty programme. In the Discussion Paper, a service is regarded as a continuous transfer of an asset normally over multiple periods; however, given that the customer consumes the asset immediately, it is difficult to verify the time at which is transferred in many cases. It is unclear how a service or an entity's asset used by a third party is explained in terms of "transfer of control", and in what sense a greater level of discipline and order is brought about compared to the existing

model. Specific application guidance should be developed after rationally summarizing the definition and attributes of services.

Question 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.

Comment:

We agree with this proposal in the sense that the satisfaction of a performance obligation is an important requirement for assessing the timing of revenue recognition. However, with respect to the notion of satisfaction of performance obligations, we believe that it is necessary to rationally summarize the basic requirement and guidance that should be taken into consideration in regards to how the issue of identification, recognition and measurement of revenue referred to in the current IAS 11 and IAS 18 are addressed, as well as the exact timing at which a performance obligation is satisfied.

The Discussion Paper states that the effects of customer acceptance (paragraph 4.21), customer intent (paragraph 4.25) and customer payment (paragraph 4.32) must be considered when determining the timing at which a performance obligation is satisfied. It is deemed that the timing at which a performance obligation is satisfied must be determined effectively not only on the basis of goods and services being transferred, but also in consideration of factors on the customer's side.

The satisfaction of a performance obligation is related to the measurement of customer's consideration, but the Discussion Paper neither clarifies the problem concerning the measurement of customer's consideration (right) in concrete terms, nor necessarily clarifies how the notion of satisfaction of a performance obligation relates to the existing revenue recognition criterion and measurement criterion referred to in current IAS 11 and IAS 18. Nonetheless, the judgment of these matters in effect may not be substantially different from the current criterion for revenue recognition based on risks and rewards of ownership. Additionally, the Discussion Paper does not necessarily clarify how the identification of a performance obligation highlighting the transfer of an asset—in other words, the transfer of control of the asset—relates to the measurement of customer's consideration.

CHAPTER 5

Question 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.

Comment:

- (a) We agree with this proposal. It may be difficult to measure the current exit price at the time of concluding a contract with a customer in many cases. If measurement of the current exit price is required at the time of concluding a contract with a customer, theoretical inconsistency may arise if remeasurement is not required in each period; however, such remeasurement in each period would be troublesome in practice.
- (b) We do not agree with this proposal. The idea that remeasurement should be done only in cases where a performance obligation is onerous seems like a compromise between the original transaction price approach and the current exit price approach, and appears to lack consistency as an approach. If a loss is expected due to changes in the contract asset or contract liability, changes in the expected cost, it would suffice to deal with it as a matter of recognition of provisions, irrespective of revenue recognition.
- (c) If a performance obligation is measured at the original transaction price, changes in the subsequent transaction price will not be reflected in the performance obligation. Since the remaining performance obligation itself will not, by nature, be directly

reflected in the financial statements, it would not affect the usefulness of investment information.

- (d) For example, in cases where the original contract consists of a provision to review the contractual amount with the customer due to price changes after entering into the contract, as is the case for raw materials exposed to high market price volatility, and in cases where the contract amount is changed due to amendments to the scope of work under long-term construction contracts, etc., the original transaction price may be reviewed based on the view that the original transaction price had been amended. However, such review of the original transaction price is based on the interpretation that the original transaction price had been changed, and is deemed to be different from adopting the current exit price approach. Therefore, it should not be considered the performance obligations under the revenue recognition model, subject to alternative measurement approaches.

Question 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 (e.g. 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.

Comment:

- (a) We agree with this proposal. Normally, the margin is deemed to include the amount passed on to the customer to recover the costs of obtaining the contract.
- (b) We believe that, in cases where the costs of obtaining the contract are not included in the original transaction price and recognised as expenses, revenue and the costs

directly contributed to obtaining the contract would not be recognized appropriately.

Question 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?

Comment:

We agree with this proposal. However, the boards have presented the *expected cost plus a margin approach* and the *adjusted market assessment approach* as examples of methods that are applicable to cases in which it is difficult to estimate the stand-alone selling price, and implied other possibilities as well. In practice, in many cases where it is difficult to estimate the stand-alone selling price, the *adjusted market assessment approach* is deemed to yield results that are closer to the stand-alone selling price. Since there may be cases where there is no other choice but to consider the *expected cost plus a margin approach*, we believe that it is difficult to categorically determine which method would be appropriate; it would be more realistic to rationally organize them by hierarchy.

Even in this case, we believe that the requirement of 'reliable measurement of the amount of revenue' should be fulfilled.

Question 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?

Comment:

We do not agree with this proposal. We believe that, if an entity does not sell a good or service separately, the entity cannot reliably estimate the stand-alone selling price of such good or service in many cases. Moreover, in many cases where an entity does not sell a good or service separately, such good or service is of no value to the customer by

itself; it is only of value when combined with another good or service.

Yours faithfully,

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