Overview

The FASB and IASB (‘the boards’) released an updated exposure draft, ‘Revenue from contracts with customers’, in November 2011 (‘the 2011 exposure draft’). They received approximately 360 comment letters in response to the updated exposure draft, down significantly from the nearly 1,000 comment letters received on the exposure draft released in June 2010 (‘the 2010 exposure draft’).

Since issuing the 2011 exposure draft, the boards have continued extensive outreach efforts, including four public and numerous private, industry-focused roundtables. Refer to Appendix B for the boards’ proposed project timeline, which details the expected timing of discussion of outstanding issues.

The boards asked whether the proposed guidance is clear and specifically requested feedback on:

1. performance obligations satisfied over time;
2. presentation of the effects of credit risk;
3. recognition of variable consideration and the revenue recognition constraint;
4. the scope of the onerous performance obligation test;
5. disclosures in interim financial reports; and
6. transfer of non-financial assets that are outside an entity’s ordinary activities (for example, the sale of property, plant and equipment).

Respondents have commented on the questions asked by the boards but also on a number of other areas, including the application of time value of money, transition and annual disclosures. Industries have also asked the boards to address or clarify the application of the proposals to certain industry-specific issues.

The boards have not yet decided on the effective date of the standard but have said that it will not be effective earlier than 1 January 2015. Early adoption will not be permitted under US GAAP; it will be permitted under IFRS and subject to EU endorsement.

Background

1. The boards decided unanimously to re-expose the proposed revenue guidance because of the importance of the revenue number to all entities and to avoid unintended consequences from applying the standard. This decision was made despite the 2011 exposure draft not significantly changing the core model proposed in the 2010 exposure draft, which requires the following five steps:

   - Identify the contract with the customer;
   - Identify the separate performance obligations in the contract;
   - Determine the transaction price and amounts not expected to be collected;
   - Allocate the transaction price to separate performance obligations; and
   - Recognise revenue when (or as) each performance obligation is satisfied.

2. Several key differences exist between the 2010 and 2011 exposure drafts despite the core model remaining largely unchanged. Changes were made in several areas including identifying separate performance obligations, determining the transaction price,
accounting for variable consideration, transfer of control and accounting for contract costs. See ‘Practical guide to IFRS – Revenue from contracts with customers,’ published in November 2011, for a detailed discussion of the key changes.

3. The boards continue to focus on industry outreach efforts and have held roundtables to gauge reactions and understand concerns with the 2011 exposure draft. Key topics raised in these meetings include identifying separate performance obligations, applying time value of money, practical challenges with applying the onerous performance obligation test, allocation of transaction price, disclosures and transition.

**PwC observation:** Striking the right balance in addressing these concerns is critical to the success of the project given that the proposed standard will eliminate industry-specific guidance. Respondents appear to believe the boards are heading in the right direction, based on the volume and content of comment letters. The remaining concerns with the exposure draft are not insignificant, however, and the boards are likely to need to address certain areas further before issuing a final standard.

4. This practical guide addresses the areas of focus in roundtables and in comment letters received by the boards on the proposed standard. References to ‘the exposure draft’ or ‘proposed standard’ refer to the exposure draft issued in November 2011, unless otherwise indicated.

**Comment letter trends and roundtable discussions**

5. The boards revised various aspects of the proposed standard in response to extensive feedback received on the 2010 exposure draft. They requested comments on those key changes, as well as feedback on whether the guidance is clear and if it will result in information that reflects the economic substance of transactions. Respondents were asked to comment on the following topics:

- performance obligations satisfied over time;
- presentation of the effects of credit risk;
- recognition of variable consideration and the revenue recognition constraint;
- scope of the onerous performance obligation test;
- disclosures in interim financial reports; and
- transfer of non-financial assets that are outside an entity’s ordinary activities.

6. Other topics such as time value of money, disclosures and transition continue to concern industry groups.

7. The number of industry-specific comments decreased since the 2010 exposure draft, but a number of concerns remain. The chart below depicts the volume of comment letters by industry.
8. Certain industry groups – such as engineering and construction, consumer and industrial products, and technology – sent far fewer letters on the 2011 exposure draft compared to the 2010 exposure draft. The volume of letters from other industry groups – such as telecommunications, automotive and entertainment and media – remained generally consistent with those received on the 2010 exposure draft.

PwC observation: We believe the number of letters significantly decreased because the boards addressed many of the questions and concerns raised in response to the 2010 exposure draft.

Areas that caused significant concern in the 2010 exposure draft – such as the accounting for services, the identification of a contract, collectibility, warranties and licences – are addressed in the 2011 exposure draft to the satisfaction of many. Challenges identified by certain industries around separation of performance obligations and allocation of transaction price are also addressed.

Proposed guidance that continues to be unpopular across all industry groups includes accounting for the time value of money, the application of the onerous test at the performance obligation level, the level of disclosures required and retrospective transition.

PwC observation: Support for the additional guidance was not unexpected, as it clarified the accounting for most service arrangements. Significant progress has been made on this issue, although there are still areas where clarity is needed.

We agree with the guidance suggested, but further clarification is needed around the delivery of repetitive goods or services. This determination might affect the pattern and timing of revenue recognition, the accounting for contract modifications and the onerous performance obligation test.

11. Respondents generally agree with the additional guidance, but confusion remains about whether a contract for the delivery of repetitive goods or services is a single performance obligation or multiple performance obligations. For example, a two-year contract for a daily cleaning service could be viewed as a single performance obligation satisfied over time or many daily distinct performance obligations.

Presentation of the effects of credit risk

12. The presentation of the effects of credit risk, meaning the consideration an entity believes will not be collected, continues to get attention from respondents. The 2011 exposure draft proposes that an entity present any allowance for receivable impairment losses in a separate line item adjacent to revenue. Both the initial assessment and any subsequent changes to the estimate are recorded in this line.

13. Respondents generally disagree with presenting the effects of credit risk adjacent to revenue; they recommend entities continue to record credit risk as an operating expense that does not impact gross profit. Most respondents have indicated that recognising credit risk adjacent to the revenue line item introduces complexities that do not exist today. Other feedback has focused on whether the effects of credit risk need to be presented on the face of the income statement or whether disclosure would be sufficient. Respondents appear to agree
that credit risk should not impact transaction price.

**PwC observation:** Only a few respondents have raised concerns about collectibility no longer being a hurdle for revenue recognition. It appears that most preparers favour such a change in the proposed standard. Investors, on the other hand, are concerned about eliminating the ‘collectibility is reasonably assured’ criteria under US GAAP. They believe the proposed constraints on revenue are not effective enough to prevent entities from recording revenue prematurely.

Investors also tend to agree with presenting revenue and any impairment losses (and reversals) as a separate line item adjacent to the revenue line, consistent with the presentation proposed in the exposure draft. This contrasts with the views of preparers, who also suggest that the presentation of credit risk on the face of the income statement might not provide added benefit in all situations. We believe that allowing entities to present this information in the notes to financial statements would be equally useful.

14. The 2011 exposure draft provides guidance on the accounting for consideration that is variable or contingent on the outcome of future events (for example, discounts, incentives and royalties). An estimate of variable consideration is included in the transaction price and allocated to each separate performance obligation. Variable consideration is only recognised as revenue when the entity is reasonably assured to be entitled to that amount. An entity needs to have predictive experience with similar performance obligations for the entity to be reasonably assured that it will be entitled to that consideration.

15. The proposed standard includes an exception to this principle for certain transactions. An entity that licenses intellectual property in exchange for royalties based on the customer’s subsequent sales of a good or service is reasonably assured to be entitled to the royalty payment when those future sales occur.

16. Treatment of variable consideration was different in the 2010 exposure draft, as the transaction price was constrained rather than the cumulative revenue recognised. There were a number of unintended consequences of that treatment, which led the boards to propose a different constraint.

17. Some respondents support the exception for sales-based royalties, but many oppose it, particularly those in the technology, and retail and consumer industries. Concerns were raised that it could drive different accounting treatments for economically similar transactions, and should therefore either be eliminated or expanded to include other arrangements where consideration is based on the customers’ sales or on other customer performance measures.

**PwC observation:** Feedback from constituents has been consistent: revenue recognition should be constrained if there is not sufficient evidence to support its recognition. Opinions diverge, however, on what constitutes sufficient evidence; some believe the amounts should be ‘virtually certain’; others support ‘probable’ or ‘more likely than not’ thresholds. The boards have proposed a qualitative threshold, as opposed to a quantitative one, but more clarity might be needed to achieve that objective.

We agree with respondents who said an exception is not needed for sales-based royalties. The proposed guidance on whether an entity’s experience is predictive should be able to sufficiently address sales-based royalty arrangements without the need for an exception.
Scope of onerous performance obligation test

18. A performance obligation was onerous in the 2010 exposure draft if the present value of the costs to satisfy the obligation exceeded the transaction price allocated to it. There was no scope limitation, and this test applied to all performance obligations. The boards revised the scope of the test to apply only to performance obligations that an entity satisfies over time and over a period greater than one year in response to concerns raised.

19. The boards now propose that a performance obligation is onerous only if the lowest cost of settling the performance obligation, being either the cost to fulfil or the cost to exit, exceeds the transaction price allocated to that performance obligation. A liability and a corresponding expense are recognised if the performance obligation is onerous.

20. Most respondents continue to disagree with assessing performance obligations to determine whether an obligation exists, citing that the accounting does not reflect the commercial substance in many arrangements. Respondents also believe that recording a loss at the performance obligation level for overall profitable contracts could result in misleading information. They contend that maintaining records at the performance obligation level is impractical, and the cost and effort outweigh the benefits. Even those entities that currently apply an onerous test for long-term contracts do so at the contract level, not the performance obligation level.

PwC observation: The onerous test continues to be universally disliked by industries that do not apply construction contract accounting today. Assessing performance obligations each reporting period to determine whether they are onerous will be challenging for many entities, and it is questionable whether the benefits of making such an assessment will outweigh the cost or effort.

Disclosures

21. The boards believe there is significant improvement to be made to existing revenue disclosures in light of criticism by regulators and users of financial statements. They have therefore proposed a comprehensive list of disclosures, for both annual and interim financial statements.

22. The proposed disclosures are intended to enable users of financial statements to understand the amount, timing and judgements around revenue and the corresponding cash flows. Required disclosures include qualitative and quantitative information about revenue, such as significant judgements made and changes in those judgements, roll-forward of balances and assets recognised for the costs to obtain or fulfil contracts.

23. The boards have proposed that interim financial statements should include most of the same disclosures required in annual financial statements, if material.

24. Preparers of financial statements acknowledge the efforts made by the boards to enhance disclosures. Most believe, however, that the pendulum has swung too far. Key concerns raised by preparers include:
   - Required disclosures are too extensive and might be based on information not used by management to manage the business.
   - The costs of providing the disclosures will exceed perceived benefits.
   - The disclosure requirements do not meet the boards' overall objective of increasing transparency and
understanding of revenue recognition because they ‘clutter’ the disclosures.

- The extent of the disclosures required appears counterintuitive to the objectives in ongoing discussions at the IASB and FASB to improve disclosure effectiveness.

25. Investors support the disclosure requirements for both interim and annual financial statements. They believe the requirements are comprehensive and will significantly enhance users’ understanding of an entity’s revenue recognition. Investors acknowledge preparers’ concerns around the volume of disclosures required but believe the requirements are reasonable given the importance of revenue.

26. Investors also recommend that non-public entities should not be exempt from certain disclosure requirements and should not be treated differently from public companies – a view not shared by most other respondents.

**PwC observation:** The boards are trying to improve the quality of disclosures, while achieving the right balance between the benefits to users of having that information and the costs to entities to prepare it. This is a fair objective given the limited disclosure requirements today. However, both interim and annual disclosure requirements proposed in the standard continue to be an area of controversy. To find the right balance, the boards have discussed holding a workshop that includes both preparers and users of financial statements to reconcile what is most critical to have in the financial statement disclosures.

We agree that revenue disclosures generally need to be enhanced. We agree with preparers, though, that the proposal requires too many disclosures and risks obscuring useful information. Removing certain disclosure requirements will better balance the objectives of the boards, desires of users and the burden on preparers. For example, we question the need to disclose items not used by management to manage the business, and wonder whether such disclosures will be meaningful.

The proposed interim disclosures appear inconsistent with the principle that interim reporting should reflect only significant changes since the last annual reporting period. The majority of preparers who responded have expressed concerns about both the annual and interim disclosure requirements, despite the boards only asking for input on interim disclosures. We believe the boards should reconsider their position on this issue.

**Transfer of non-financial assets that are outside an entity’s ordinary activities**

27. The boards have proposed that the guidance on transfer of control and recognition of variable consideration in the proposed standard should also be applied to transfers of non-financial assets that are not an output of an entity’s ordinary activities such as PPE.

28. This guidance would determine when an entity should derecognise an asset and would provide guidance on how to measure any gain or loss on sale. The boards asked for specific feedback in this area, as the recognition constraint would have an effect on the gain or loss when the consideration is variable.

29. Most respondents did not comment on this area. Those that did respond generally agree with applying the guidance to non-financial assets. Others disagree, advocating that current guidance be retained.

**PwC observation:** This is an area that might have gone unnoticed by many respondents. We support applying the guidance in the proposed standard to the transfer of non-financial assets that are not part of an entity’s ordinary activities. We recommend the scope of the guidance be clear, given there are currently different derecognition models and measurement guidance depending upon the nature of the item sold and whether an entity is applying US GAAP or IFRS.
Time value of money

30. The proposed standard specifies that an entity reflect the time value of money to determine the transaction price if the contract has a significant financing component.

31. An entity that expects, at contract inception, that the period between payment by the customer and the transfer of goods or services to the customer will be one year or less does not need to consider the time value of money. This is a practical expedient introduced to address concerns about the burden and complexity of applying this guidance.

32. Respondents generally understand the conceptual basis for incorporating the time value of money into the transaction price, but they continue to express concerns over the complexities and practical challenges associated with it. They are particularly concerned about the need to implement systems and processes to account for the time value of money. The majority of respondents across industries argue that the cost outweighs the benefit to users and recommend this requirement be removed.

33. Some suggest that the practical expedient be removed, as it is arbitrary and does not provide adequate relief.

PwC observation: The volume of feedback in this area and the general direction of that feedback came as no surprise. Feedback through roundtables and other forums has been consistent with that noted in the comment letters. Generally, respondents (including users) believe that an entity should account for the time value of money when it is apparent that the contract contains a significant financing component; however, respondents are concerned with the complexity of applying this guidance.

We understand the conceptual merit of considering the time value of money to determine the transaction price, but we also share constituent’s concerns. The practical challenges of applying this guidance could outweigh the benefit to users in some situations. System and process changes will also be needed, at potentially high cost, for preparers to apply the guidance.

Transition

34. It is unclear when a final standard will be issued, but it is likely to be early 2013. The boards have not yet decided on the effective date of the standard but have said that it will not be effective earlier than 1 January 2015. Early adoption will not be permitted under US GAAP but will be permitted under IFRS.

35. The boards propose that the standard be applied retrospectively, with certain optional reliefs. The boards affirmed that comparability and understandability of revenue recognised before and after the new standard is adopted outweighs concerns raised about costs and efforts of applying the guidance to prior periods. The boards believe entities will have sufficient time between the standard being issued and the effective date to prepare and compile the necessary information.

36. The boards have provided entities with several practical expedients to ease the burden of transition, as follows:

- Contracts that begin and end in the same annual reporting period do not need to be restated;
- The transaction price at the date the contract was completed can be used for contracts with variable consideration that were completed on or before the effective date;
- The onerous performance obligation test does not have to be applied to performance obligations in prior periods unless an onerous contract liability was recognised previously; and
- Disclosure of the amount of the transaction price allocated to remaining performance obligations and the expected timing of revenue recognition (or ‘maturity analysis’) is not required.
37. Financial statement preparers acknowledge that retrospective application will provide users valuable information. Their primary concern is the added burden of applying both the proposed standard and current guidance to large and complex multiple-element arrangements and long-term contracts that span multiple periods. Many respondents believe maintaining a dual reporting system for up to three years is not practical or cost-effective.

38. Other concerns raised by respondents point to potential unintended consequences from retrospective application, including implications for previously filed tax returns or compensation arrangements.

39. An overwhelming number of respondents recommend the boards allow some form of prospective adoption of the standard or at least allow prospective application when it is not practical for entities to apply the standard retrospectively. Many also support permitting early adoption for all entities, not just those under IFRS.

40. Although users of financial statements acknowledge the burden of retrospective application on preparers, they support the proposed transition method and believe it is necessary for meaningful financial analysis. Instead of providing an option for another transition method, as proposed by preparers, users suggest that a better approach would be to delay the effective date of the proposed standard to give preparers more time to implement. 

PwC observation: Transition continues to be one of the most loudly voiced concerns. While retrospective application might increase consistency across periods, the effort involved might outweigh the benefits. The practical expedients reduce some challenges, but there could be other implications that need to be considered, including statutory or regulatory requirements.

Industry perspectives

41. Industry groups have been active in commenting, both verbally and in writing, on the 2011 exposure draft. They continue to express concerns with aspects of the proposed standard, some of which are common themes across multiple industries; others are more specific to one industry.

42. This section summarises specific issues and concerns raised by industries through the boards’ outreach efforts. Some of the concerns raised during this outreach period, while less in volume than heard in relation to the 2010 exposure draft, remain significant to specific industries. The boards might need to reconsider certain proposals before issuing a final standard if they are to resolve some of these issues.

43. Certain industry groups are still struggling with aspects of exposure draft. For example, the telecommunications industry continues to be concerned about the allocation of the transaction price in bundled arrangements and accounting for contract costs; the automotive industry has different views on how to account for non-cash incentives; the entertainment industry is concerned with revenue recognition for licence arrangements. The volume of comment letters remained relatively flat for these industries; however, the content of the comments is more focused on these specific issues.
Aerospace and defence

Identification of separate performance obligations

45. A majority of respondents in the aerospace and defence industry believe that a contract for the production of several similar items for a government, such as aircraft, is a single performance obligation, as the contract is negotiated and managed on a combined basis. Many in the industry hold the view that the production of each individual unit is not distinct because the production process is highly interrelated and some of the items are highly customised to meet the customer's specifications. Respondents have highlighted that the proposals can be interpreted such that each unit produced under the contract is a separate performance obligation because the units are not highly interrelated with each other. Respondents therefore recommend the boards clarify the guidance.

Performance obligations satisfied over time

46. Revenue should be recognised by measuring the progress toward satisfaction of a performance obligation if it is satisfied over time. Most respondents agree with the proposals but question the timing of cost recognition when an output measure, such as units of delivery, is used to measure progress. Many are concerned that contract costs will be expensed as incurred as a fulfilment cost. This is a change from today's contract accounting guidance, which respondents feel will distort the margin during contract performance and does not therefore reflect the economics of a contract that is satisfied over time. These respondents recommend that entities be allowed to use a systematic and rational approach for recognising contract costs to reflect the single overall profit margin of the arrangement.

Contract modifications

48. Contract modifications occur frequently in the aerospace and defence industry. These modifications include changes to scope or price, including some
that might be unapproved or in dispute (known as ‘claims’). Generally, these modifications are approved after the contractor provides the related service. Respondents believe the proposed standard is unclear on the accounting for such modifications and recommend carrying forward existing guidance on the accounting for contract modification for construction contracts. This existing guidance is similar under IFRS and US GAAP and allows for recognition of amounts subject to claims or unapproved change orders in certain circumstances.

**PwC observation:** The aerospace and defence industry is generally satisfied with the direction of the 2011 exposure draft. This industry was especially active in working with the boards during their redeliberations to share concerns and related business implications. The boards listened, and many of the concerns expressed on the 2010 exposure draft by this industry were addressed.

Not surprisingly, the main concerns that remain are those that could drive different accounting results from the contract accounting models used today under both US GAAP and IFRS.

### Automotive

49. The table below captures significant topics that concern this industry.

We have summarised the most significant issues and concerns below. The percentages represent the percentage of responses within an industry group that commented on a specific topic.

**Consideration payable to a customer**

50. Automotive manufacturers typically sell vehicles through an independent network of authorised dealers, who then sell the vehicles to the retail consumer. At the same time, the manufacturer commonly offers incentives directly to the retail consumer, including promises to provide free goods or services such as maintenance on the vehicle. Respondents are uncertain as to how to account for these non-cash incentives when they are offered directly to their customer’s customer (that is, the retail consumer).

51. Some believe that the cost of non-cash incentives should reduce the transaction price, similar to cash paid to a customer’s customer, as the manufacturer does not perform the services promised. Others believe the promised good or service is a separate performance obligation and some revenue should be deferred at the time of sale to the authorised dealer. To the extent the promised good or service is not regularly sold separately by the manufacturer and its cost is incidental to the cost of the vehicle, some have proposed that the boards consider allowing the incentives to be accounted for as a cost-accrual. Despite the varying perspectives, most agree that additional clarity on the accounting for non-cash incentives promised to the customer’s customer is needed.

**Warranties**

52. Accounting for warranties continues to be an area of focus for the automotive industry. The industry supports the boards’ proposal that assurance-type warranties should be accounted for as a...
cost accrual similar to today. The industry remains concerned about the requirement to account for a warranty as a separate performance obligation if there is a service component that the entity is unable to separate. Some do not believe that accounting for the service component of the warranty separately is practical. They also do not believe it represents the underlying economics of the arrangement unless that portion of the warranty is more than incidental to the assurance warranty. Respondents also do not agree that the length of the warranty period should determine whether a warranty includes a service element.

**Repurchase agreements**

53. Automotive manufacturers sell vehicles to customers and often include repurchase or reimbursement options as part of the contract. This is common in arrangements with rental car companies, for example. These agreements are commonly structured as either: (1) the buyer has an option to put the vehicles back to the seller; or (2) the seller guarantees the residual value of the vehicle at the end of a specified term, such as 12 months.

54. The exposure draft results in different accounting for these arrangements. An unconditional obligation to repurchase the vehicle is a lease if the customer has a significant economic incentive to put the vehicle back to the manufacturer. The agreement is a sale if the manufacturer must reimburse the customer for any deficiency between the sales proceeds and a minimum resale value. Any expected reimbursements reduce the transaction price at the time of sale. Respondents believe these are economically similar transactions that should be accounted for in the same way. Some respondents have also requested the boards define ‘unconditional obligation’ to avoid diversity in practice, as the repurchase agreements are typically conditional on the vehicle being returned in a certain condition and within a certain time period.

**PwC observation:** The automotive industry has generally supported the overall objectives of the proposed guidance. The remaining concerns, particularly around consideration payable to a customer, require the boards to further clarify guidance, as the guidance in the 2011 exposure draft is not being consistently interpreted by entities within the industry.

**Consumer industrial products**

55. The consumer industrial products sector comprises a range of entities involved in the production of goods and delivery of services across a diverse industry base. This includes industrial manufacturing, metals, chemicals, forest products, paper and packaging entities. The wide range of entities in this industry voiced concerns on a variety of issues.

**Uninstalled materials**

56. Respondents have raised concerns with the guidance on uninstalled materials when an entity uses subcontractors who provide ‘as is’ equipment for installation into a final product or service. The exposure draft requires the revenue recognised for this performance obligation to equal the cost of the equipment acquired from a subcontractor (that is, a 0% profit margin). Respondents disagree with allocating a 0% profit margin for goods purchased from a subcontractor, contending that the entity is providing the customer a ‘turn-key’ solution not just passing through the equipment.

**Licenses**

57. Franchisors generally do not agree with the proposed accounting for licence arrangements with variable consideration. There is specific concern with recognising royalty revenue prior to the related sale by the franchisee. They believe these arrangements are economically similar to royalties based on a customer’s subsequent sale in a licence of intellectual property and that revenue should be recognised over time as the royalties are earned.
**Engineering and construction**

58. The table below captures significant topics commented on by this industry. We have summarised the more significant issues and concerns below. The percentages represent the percentage of responses within an industry group that commented on a specific topic.

**Identification of separate performance obligations**

59. The engineering and construction industry is concerned that the proposed definition of a distinct performance obligation in the 2010 exposure draft might require contracts to be accounted for as numerous separate performance obligations, which might not reflect the substance of the contract. The 2011 exposure draft clarifies that promised goods or services are not distinct if they are highly interrelated and significantly customised.

60. Some concerns around identifying separate performance obligations remain, despite the industry generally being pleased with the clarifications made by the boards. The guidance indicates that every contract that contains a bundle of highly interrelated and significantly customised performance obligations must be a single performance obligation. This might often be the case, but there are situations where performance obligations are distinct yet also highly interrelated and significantly customised (for example, a contract with engineering, procurement and construction services bundled together). Respondents recommend the boards revise the guidance to allow for the application of reasonable judgement in applying the principle to identify separate performance obligations.

**Uninstalled materials**

61. Common in many engineering and construction contracts is the use of third parties, such as subcontractors to construct goods specifically for a project. These goods could remain uninstalled for a significant period of time – for example, due to long lead times to engineer, fabricate and construct these items. The proposed standard requires an entity only to recognise revenue to the extent of the cost of such uninstalled materials.

62. Respondents generally believe the profit recognised on goods specifically produced for the project should be consistent with the contract as a whole, as contracts are typically bid with an overall profit margin in mind, not separate, distinct profit margins for different phases of the project. Transfer of materials customised specifically for a project represents progress towards satisfying the performance obligation. Respondents therefore propose that profit consistent with the overall contract be recognised on such uninstalled materials when measuring progress toward satisfying the performance obligation.

**Contract modifications**

63. Contract modifications occur frequently in the engineering and construction industry. These modifications include changes to scope or

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**Summary of Comments**

[Chart showing the summary of comments with categories such as Onerous Test, Contract Costs/Uninstalled Materials, Disclosures, Transition, Separate Performance Obligations, and Contract Modifications, with respective percentages]
price, including some that might be unapproved or in dispute (known as ‘claims’). Generally, these modifications are approved after the contractor provides the related services. Respondents believe the exposure draft is unclear on the accounting for such modifications; they recommend carrying forward existing guidance on the accounting for contract modifications for construction contracts. This existing guidance is similar under IFRS and US GAAP and allows for recognition of amounts subject to claims or unapproved change orders in certain circumstances.

**PwC observation:** The engineering and construction industry have expressed broad support for the boards’ overall objectives; however, many in the industry (both preparers and users) do not believe the proposed model improves existing accounting. That said, the industry is generally satisfied with the direction of the 2011 exposure draft. Similar to the aerospace and defense industry, this industry has been active in working with the boards during the redeliberation process and, in fact, many of their concerns were addressed in the 2011 exposure draft.

There is only a short list of concerns that remain and it is not surprising that these center on the nature of certain business practices in this industry. We believe the proposed revenue guidance could benefit from clarification in these areas.

**Entertainment and media**

64. The table below captures significant topics that remain top of mind for this industry. We have summarised the more significant issues and concerns below. The percentages represent the percentage of responses within an industry group that commented on a specific topic.

**Licenses**

65. Some constituents have raised concerns over the accounting for perpetual licences and time-based licences, arguing that the two are economically different and, should therefore be accounted for differently. They believe revenue from perpetual licences should be recognised when the licence transfers and revenue from time-based licences should be recognised over the relevant period. Others question this distinction and highlight that it might be difficult to determine whether a licence is perpetual or time-based if renewal options or cancellation clauses exist.

66. Many long-term licence arrangements for film and television contain licensor-imposed restrictions. These might include interruptions on the right to use the licence during the licence term or constraints on the frequency and...
timing of the use of the licence. For example, it is common for a licensor of an episodic television series to specify how the episodes should be sequenced, and with what frequency and over what time frame the episodes may be aired. Many respondents highlight that these complexities result in significant judgement to determine when control transfers. They believe additional clarity is needed to avoid inconsistent application of the guidance to such arrangements.

67. Digital distribution of licensed content has become more prevalent in the entertainment and media realm. A library or portfolio of content might be provided under a single arrangement; however, the content might be substituted or refreshed throughout the licence term. Respondents question whether arrangements to distribute licensed intellectual property over certain digital platforms should be accounted for as a service arrangement satisfied over time, which many believe better reflects the economics of such transactions, rather than a performance obligation satisfied at a point in time when the licence is provided.

Onerous performance obligations

68. The onerous test is likely to add significant complexity to the accounting within this industry. The boards have been asked to clarify how to apply the onerous test when an entity pools its related programming costs. Programming assets are often recovered through cash flows from multiple distributor arrangements and advertising revenues. Respondents in the industry believe that when there is a pool of costs shared among several customer contracts, an onerous test applied at a level even higher than the contract would be more practical and better reflect the economic substance of these transactions. Some respondents also feel that the onerous test contradicts existing impairment guidance for these assets, as loss recognition could occur even though the underlying programme investment is profitable.

Financial institutions

69. Financial services companies such as banking institutions, insurance companies, real estate and asset managers commented on a variety of issues. However, the applicability of the ‘reasonably assured’ constraint on performance fees is one of the main concerns highlighted by asset management entities. The customer loyalty programme for credit cards is one of the main concerns highlighted by banks and other financial services entities.

Asset management

‘Reasonably assured’ constraint

70. Common revenue streams in scope of the proposed standard are performance fees, management fees and upfront fees. Respondents are primarily concerned with the potential impact the proposed standard might have on performance fees. Performance fees are usually based on the value of investments managed by funds, subject to certain thresholds (for example, hurdle rate, high water mark and internal rate of return). Performance fees are often subject to clawback
provisions, requiring the return of a portion of the fees received if the cumulative performance results of the fund are lower than expected. This raises concerns as to when the fees should be considered reasonably assured. Revenues could be deferred in some cases if the payments are not reasonably assured until there is no risk of return, which could result in revenue being recognised well after the cash has been received.

71. Respondents are concerned that the overall usefulness of their financial statements will decline as a result of deferring revenue in such situations. Respondents believe the treatment of performance fees is well understood in the industry and recommend the boards conduct further industry consultation before issuing a final standard.

PwC observation: The proposed standard might impact the timing of the recognition of performance fees, as these fees may be highly susceptible to external factors such as market risk.

Under current US GAAP, asset managers can apply one of two methods to account for performance fees. We do not expect the proposed standard to significantly affect asset managers that currently recognise performance fees in the periods during which the related services are performed and all the contingencies have been resolved. On the other hand, asset managers that currently recognise performance fees using the ‘hypothetical liquidation’ method will be affected, as under this approach revenue is typically recognised in advance of the amount becoming reasonably assured, as defined under the proposed standard.

Asset managers currently reporting under IFRS will not generally be significantly affected by the proposed standard, as the majority of asset managers already recognise performance fees when the fee becomes reliably measurable, which is often at the end of the performance period when the outcome is known.

Financial services

Customer loyalty programmes

72. The banking and capital markets industry is concerned about whether credit card loyalty programmes are in the scope of the proposed standard. A card issuer earns a processing fee from the merchant on the revenue transaction that occurs between the merchant and the cardholder in a typical credit card reward programme. The cardholder earns reward points from the card issuer at the same time. Some respondents argue that these are two separate arrangements, one with the merchant for the processing fee and another with the cardholder for the reward programme.

73. Respondents recommend that the boards clarify how to apply the proposed standard to these multiple-party arrangements if they are in the scope of the standard. They also highlight that the example included in the exposure draft on customer loyalty programmes is not applicable to credit card reward programmes because the awards arise out of a transaction outside the scope of the revenue standard (that is, a financing arrangement).

74. Many respondents interpret the proposed guidance to mean credit card loyalty programmes are outside the scope of the proposed guidance, as the card issuer, the merchant and the cardholder are unrelated parties, and there is no price interdependency among these contracts.

75. Respondents also have noted that the guidance on measuring the transaction price seems to provide an exception to the contract-combination guidance. Consideration payable to a customer or to other parties that purchase the entity’s goods or services is treated, in either case, as a reduction of the transaction price with the customer. Respondents therefore believe that additional clarity is needed to understand whether credit card reward programmes are scoped into the proposed guidance.
Some respondents have suggested that accounting for credit card loyalty credits as performance obligations will introduce significant complexity to existing accounting. Many credit card issuers currently recognise the cost of loyalty rewards as an offset to merchant fee income when rewards are earned, and record a corresponding liability. Respondents believe that applying the proposed guidance will require cash rewards to be netted against merchant fee income as a reduction of the transaction price, but non-cash rewards will result in only a deferral of recognition, as the transaction price would remain the same. Respondents consider cash and non-cash rewards to be economically similar and believe they should not have different accounting treatments.

PwC observation: The industry has been vocal both in roundtables and in comment letter responses that they do not believe that the proposed accounting is appropriate for credit card loyalty programmes. There are concerns about the accounting for loyalty awards that are provided outside of a revenue transaction, such as upon opening a credit card account.

We believe it is also unclear which revenue streams should be considered to determine the amount of revenue to be deferred – that is, whether it is payments made by the card holder to participate in the programme, merchant fees, interest charged to the card holder or some combination of the above. We agree it is unclear and that the boards need to provide greater clarity on the accounting for contracts that involve multiple parties.

Pharmaceutical, life sciences and health care

Respondents from this industry commented on a variety of issues. The key areas focus on the definition of a customer and accounting for collaboration arrangements.

Definition of a customer

The exposure draft defines a customer as the party contracted to receive output of an entity’s ordinary activities. It further states that the counterparty in a contract might or might not be a customer, and lists a collaborator or partner as an example of this. Respondents from the industry are concerned that there can be arrangements in which the definition of a customer under the proposed standard is not clear. Respondents are looking for further guidance on how to account for these arrangements.

Collaboration arrangements

Collaborative arrangements in the industry commonly focus on product development but also include other activities such as distributing and marketing a product. The proposed standard only refers to collaboration agreements that are focused on product development. Respondents recommend broadening this to include other types of collaboration agreement that should be scoped out of the proposed standard.

PwC observation: Certain collaboration arrangements in the biotechnology industry might be with parties that are not customers and therefore appear out of scope. Being a collaborator in an arrangement does not automatically mean the contract is scoped out of the revenue standard, as such contracts can have both revenue and non-revenue elements. Judgement will be needed to determine which elements of such arrangements should be accounted for under the revenue standard and which will be accounted for under other guidance.
Technology

80. The table below captures significant topics that remain a concern for this industry. We have summarised the more significant issues and concerns below. The percentages represent the percentage of responses within an industry group that commented on a specific topic.

Identification of separate performance obligations

81. The identification of separate performance obligations continues to be an area of concern for the technology industry. Respondents’ interpretation of the proposed standard suggest that even though bundled arrangements have components that meet the distinct criteria, the entity would have to account for the arrangement as a single performance obligation if the bundled goods or services are highly interrelated and customised.

82. It is common in the software industry to sell a licence and related implementation and customisation services separately. There is concern that the proposed guidance implies that if the entity is awarded the service with the licence in the bidding process, this would be accounted for as a single performance obligation. In some situations, this results in revenue for the licence being deferred and recognised in accordance with the transfer of control over time in combination with the implementation and customisation services. This is a contrast to when the licence and service are not awarded at the same time, which would result in revenue for the licence being recognised upon transfer to the customer.

Contract costs

83. A majority of respondents from the technology industry disagree with capitalizing incremental costs of obtaining a contract with a customer, such as sales commissions. Sales commissions are commonly based on a variety of measures such as overall contract performance or customer satisfaction and rarely are based solely on contract acquisitions. Respondents acknowledge the practical expedient, but believe the one year exclusion is arbitrary. They recommend allowing a policy election to avoid the operational burden of this guidance as they feel the benefit to users of financial statements is not significant.

PwC observation: There were a number of software companies that responded to the 2011 exposure draft that still have concerns about accounting for software deliverables. The principles of the proposed standard will result in virtually all of the deliverables that are currently included in most software transactions (licence, PCS, services, etc.) being accounted for separately. Software companies that recognize licences and post-contract support ratably over the contractual term due to the inability to establish vendor-specific objective evidence will be required to separate the deliverables under the proposed guidance. As a result, revenue may be accelerated and some software companies are reluctant to abandon the ratable revenue recognition model in these cases.
The proposed guidance could also require entities to defer more costs. Specifically, those entities that expense sales commissions as paid and set-up costs as incurred could now be required to capitalise and amortise these costs. Respondents believe the proposed guidance could be an operational burden for entities that currently expense all contract costs as incurred, except where the practical expedient applies.

**Telecommunications**

84. The table below captures significant topics commented on by this industry. We have summarised the more significant issues and concerns below. The percentages represent the percentage of responses within an industry group that commented on a specific topic.

85. Telecom respondents have primarily focused on two key areas of concern: (i) the allocation of transaction price; and (ii) costs to obtain a contract.

**Allocation of transaction price**

86. Wireless service providers typically offer highly subsidised handsets to customers signing up for a service plan. Standalone sales of wireless devices do occur but are typically limited to sales to third-party resellers or dealers, or direct sales to customers replacing a lost or broken device. Telecommunication entities view neither instance as indicative of the selling price of devices if sold regularly on a standalone basis to customers.

87. The proposed guidance eliminates the contingent revenue cap that currently exists under US GAAP and is regularly applied by the industry. That is, the amount allocated to a delivered item is limited to the amount that is not contingent upon the delivery of additional items or meeting other specified performance conditions (that is, the non-contingent amount). Revenue allocated to the subsidised handset would be greater under the proposed standard, resulting in earlier revenue recognition. Respondents do not believe this represents the economic substance of these transactions, as the industry focuses on the service aspect of these transactions as opposed to the sale of the handsets.

88. As proposed in the exposure draft, using the residual approach is limited to situations where the standalone selling price of a good or service is highly variable or uncertain. Some respondents propose to expand the scope of the residual approach to also include goods or services sold infrequently on a standalone basis. Others propose refinements to the guidance on allocating a discount to specific performance obligations, which they believe better reflects the economics of selling deeply discounted handsets to customers.

**Contract costs**

89. Respondents generally oppose the requirement to capitalise incremental costs of obtaining a contract. They note that capitalising sales commissions will require significant estimation and periodic impairment evaluations that would introduce judgement and variability to an
otherwise uncomplicated process. Respondents propose removing the requirement to account for costs to obtain a contract from the proposed standard or allowing constituents to have a policy election for immediate recognition of expense.

**PwC observation:** The telecommunications industry has been one of the most vocal in providing feedback to the boards, in public and private roundtables, comment letters and other communications. The industry vehemently disagrees with the allocation of revenue to the mobile phone handsets in an amount that exceeds cash received, as they feel this does not represent the economics of their business. They also contend that the costs to change systems and processes will be significant.

We understand the concerns of the industry and the practical challenges of implementation; but we believe that any proposed solution needs to be consistent with the principles in the model so as to avoid unintended consequences to other industries.

**Next steps**

90. The boards will begin to redeliberate the proposed standard in June 2012. We have included the proposed redeliberation timeline in Appendix B, which details the expected timing of discussion of outstanding issues by the boards.
### Appendix A – Summary of significant comment letter topics by industry group

<table>
<thead>
<tr>
<th>Topics</th>
<th>Aerospace &amp; Defense</th>
<th>Automotive</th>
<th>Consumer Industrial Products</th>
<th>Engineering &amp; Construction</th>
<th>Entertainment &amp; Media</th>
<th>Financial Institutions</th>
<th>Pharma, Life Sciences, &amp; Health Care</th>
<th>Technology</th>
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## Appendix B – Boards’ proposed project timeline

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<thead>
<tr>
<th>Month</th>
<th>Topic</th>
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<td>June 2012</td>
<td>Identification of separate performance obligations (Step 2)</td>
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<td>July 2012</td>
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<td>December 2012</td>
<td>Sweep issues and consequential amendments</td>
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<td>Q2 2013 and thereafter</td>
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1 Excerpted from page 21 of the Staff Paper, *Revenue recognition — Project plan for redeliberations*, discussed at the 21-25 May 2012 IASB and FASB public meeting. The Staff Paper is copyrighted by the Financial Accounting Foundation and the IFRS Foundation, and this excerpt has been reproduced with permission. The Staff Paper was prepared by the staff of the FASB and IFRS Foundation for discussion at the public meeting. It does not purport to represent the views of any individual members of either board. Comments on the application of US GAAP or IFRSs do not purport to set out acceptable or unacceptable application of US GAAP or IFRSs. The FASB and the IASB report their decisions made at public meetings in FASB Action Alert or in IASB Update.