

# Rådet för finansiell rapportering

The Swedish Financial Reporting Board

RFR-rs 2009:10

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

Dear Sirs,

## Re: Discussion Paper – Preliminary Views on Revenue Recognition in Contracts with Customers

The Swedish Financial Reporting Board is responding to your invitation to comment on the above Discussion Paper (DP). Revenue is an important item in the financial statements. Revenue is often used as a measure of activity in an entity and a starting point for making predictions of profits and cash flows.

We strongly support the use of the customer consideration model instead of the fair value model. Nevertheless we believe that the proposals in many cases will lead to substantial changes that will not improve financial reporting.

We have concerns about the “single approach”, that is proposed. We note that the Boards consider excluding some areas from this standard. Having exceptions is an indication that there might be problems with one, single approach (or at least the way it is proposed in the DP). It seems that the relatively recent standard on agriculture would be hard to combine with a revenue recognition principle resting on the control definition proposed by the DP. Presumably, the same would be true for leasing, but for other reasons. We are also concerned about the treatment of interest payments, dividends and other payments related to financial instruments, which might also be outside the scope of the proposed standard. Restricting the standard to “revenue contracts” will not solve the underlying problems, if the accounting for items not covered by the standard will be based on different accounting principles.

Furthermore, the problems identified in the introduction (S2, p.7) seem to be different. The US GAAP problems seem to originate from a rules-based approach with different detailed guidance across industries. The problems identified in the IFRS context have to do with drawing the line between IAS 11 and IAS 18 and the difference between short-term and long-term contracts.

### Long-term contracts

The problems associated with revenue recognition are related to two major areas: multi-element arrangements and long-term contracts. The analysis in the DP is

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primarily about multi-element arrangements. While we strongly support that the problems related to this area have been addressed, we note that the proposals are very close to US GAAP and are concerned that the more detailed specifications of US GAAP are transferred to the more principles-based IFRS.

We do not think that the problems related to long-term contracts have been analysed to the same extent as multi-element arrangements. We note from the DP that many of the topics (such as combining contracts, changes in the contract's terms and conditions after contract inception, aspects of onerous contracts, gross or net presentation models, cost recognition guidance) not covered in the DP have a specific bearing on long-term contracts. Our contacts with Swedish industry also indicate that e.g. construction companies, shipping companies and software companies have much more concerns with the proposal than manufacturing companies. Possibly, this has to do with important issues related to long term projects not being adequately dealt with.

Related to long-term contracts, the proposal will most probably lead to a separation of financial accounting and management control. This would create unwarranted differences between segment reporting and financial statements. Even though the alignment of financial accounting and management control is not self-evident, one has to take this as a signal that some parts of the proposal have to be reconsidered.

## **Risks and rewards**

Our main overall concern with the proposal relates to replacing the risks and rewards concept by the control concept to decide when there is a transfer and thus when revenue is recognised. This means replacing economic considerations by legal considerations. Of course, the legal implications are one aspect of the economics of a transaction, but the economics of a transaction are much broader than that.

We are not convinced by the argument against the risks and rewards notion provided in the DP (4.17, p.45), that if the risks are shared by more than one party in the contract, that makes the risks and rewards notion difficult to apply. According to the DP, this requires an entity to judge whether the risks and rewards have been transferred and this judgement could vary from one transaction to another. While we acknowledge the existence of such judgements, we do not share the reluctant attitude towards them. In a principles-based standard there will always be a need and room for professional judgement, and we can think of many other accounting issues where more difficult judgements are required.

The risks and rewards approach is closer to most entities business models. Consider e.g. an order for a network. In a normal delivery of a network, the customer would start using the asset before the supplier will recognise revenue due to the supplier still bearing risks and rewards. Possibly revenue would be recognised earlier if the control concept is used instead. Consequently, there might be a lower focus on risk.

This replacement of risks and rewards by control is more important than the shift of focus from an earnings process approach to an asset liability view. In our opinion the earnings process approach and the asset liability view are not as different as they are made out in the DP. It is said (1.8 p.18) that an earnings process approach gives little consideration to how assets and liabilities change. That is not altogether true. Traditional criteria for revenue recognition are: an increase in asset value, the existence of a transaction, and a substantial completion of the earnings process.

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Actually this is implicitly acknowledged in the DP, talking about "the earnings process could be improved". In our opinion however, the shift away from the risks and rewards notion doesn't improve financial accounting. In fact, such a change might lead to new problems, more serious than the problems associated with the present practice.

Furthermore, it is said in the DP (1.10 p.19) that an application of the risks and reward concept (with an earnings process approach) could result in amounts that do not represent economic phenomena and are inconsistent with the definition of an asset. Actually, an earnings process approach is not that different from an asset and liability view. The earnings process approach considers assets and liabilities, and the asset and liability view is not independent of risks and rewards. The first part of the definition of an asset says that it rests on future economic benefits accruing to the entity (the second part is about control). This concept of future economic benefits is closely related to getting rewards (which in turn is inextricably linked to the concept of risk).

## **Control definition**

Having an economic perspective, the focus would be on changes (increases) of economic value. Such increases would be the result of activities of an entity to satisfy the needs of a customer. We agree that the customer perspective should be emphasised. Activities of an entity that don't satisfy customer needs don't increase economic value. However, we disagree with the way the customer perspective is represented. The problem is the control definition applied to the customer perspective.

There is a focus on legal form rather than economic substance. This is a step back. This will probably lead to increased transaction (contract) structuring (cf the design of financial instruments with the aim to qualify for a preferred accounting treatment). We also believe that much effort will be spent on clarifying legal status in different jurisdictions, not necessarily of any bearing to the economics of transactions.

In addition to that, we are concerned about how the different factors significant to transfer of control mentioned in 4.43 (buyer specification, payment terms and right to work in progress) relate to each other. In 4.43 it seems that a comprehensive judgement would be made. We favour principles-based standards and support that interpretation. However, we fail to see how this would be superior to the risks and rewards approach in terms of need for professional judgement.

## **Continuous transfer**

We are also not fully clear on the concept of continuous transfer and think that this concept should be properly defined. The point is made that both goods and services are assets (a service is an asset that is consumed upon delivery). Is there a difference between goods that are transferred continuously and services & materials? Are there long term contracts where separate performance obligations results in revenue recognition at discrete points in time and not continuously as in the PoC-method?

Furthermore, what is the role of customer acceptance related to the continuous transfer concept? Often, advance payments/ progress billing do not constitute customer acceptance, they are only a means of financing the production. In practice, two kinds of contracts are often identified: high uncertainty contracts (customer acceptance required) and low uncertainty contracts (the entity makes its own judgement) respectively.

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In reference to A38, we are not clear, whether there are situations characterised by continuous transfer, spanning over more than one reporting period, where a method like the percentage-of-completion method is applicable.

## **Customer acceptance**

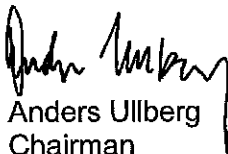
Regarding customer acceptance conditions, we are concerned with how to identify "formalities" in a basically legal (i.e. formal) context. Assume that a supplier delivers some products. The supplier considers the products to be standard products, the customer acceptance to be a formality and consequently the obligation to be fulfilled. Revenue is recognised. The problem is that the customer might not engage in this kind of transaction very often and acceptance might not be a formality to him.

We consider that the best approach to solve the problems associated with present practice is to conduct a thorough analysis of the risks and rewards concept and the application of it to make it possible to apply the concept more consistently and therefore consider that the IASB should pursue this route instead.

If you have any questions concerning our comments please address our Executive member Carl-Eric Bohlin by e-mail to:  
[carl-eric.bohlin@radetforfinansiellrapportering.se](mailto:carl-eric.bohlin@radetforfinansiellrapportering.se).

Stockholm, July 6, 2009

Kind regards,



Anders Ullberg  
Chairman