BUSINESSEUROPE

EFRAG
13 – 14 Avenue des Arts
1210 Bruxelles

17 December 2007

Dear Sirs,

RE: PAAinE Discussion Paper on Revenue Recognition

1. General Remarks

BUSINESSEUROPE highly appreciates the opportunity to comment on the Discussion Paper on Revenue Recognition issued by EFRAG in co-operation with the German Accounting Standards Committee GASC, and the Conseil National de la Comptabilité CNC. Revenue is indeed an essential number that users of our financial statements, and we ourselves consult in analysing our entities' performance. Therefore, we strongly support the idea of defining a European view on revenue recognition "proactively" in order to influence the current IASB/FASB joint project to develop comprehensive principle-based concepts for revenue recognition.

Revenue is a number that must be prepared applying objective and reliable criteria that allow for different entities in different industries to be comparable. In principle, we believe that different types of transactions may well follow different approaches of revenue recognition, a single approach that covers all transactions is ultimately not necessary to provide clear comprehensive guidance on revenue recognition, nor practicable from our point of view.

Approaches suitable for revenue generating transactions must be both, adaptable and based on objective criteria. The Discussion Paper introduces and analyses two approaches to revenue recognition: The critical events approach and the continuous approach. Basis for revenue recognition is the principle that revenue is defined as a change in assets and liabilities that arise from a contract with a customer. Our comments focus primarily on the question how suitable each approach is to reflect different types of transactions and whether it leads to reliable results for readers of financial statements.

We are very much concerned that the continuous approach, if applied to all transactions, would not only increase complexity in preparing financial statements but also at the same time reduce understandability, relevance, reliability and comparability of revenue numbers presented. We believe that a critical events approach that considers the economic substance of an obligation in determining whether and if so how the entire contract obligation is to be split into sub-contract obligations would be best suited to reflect most (but not all) revenue generating transactions. The approach should emphasize the question under which circumstances a separation of part-obligations is adequate.

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2. Appraisal of the different approaches

Under the critical events approach revenue arises upon occurrence of a particular event, either upon

- Fulfilment of all performance obligations under the contract (Approach A), or
- Fulfilment of all performance obligations under a part-contract as defined by the "master"-contract (Approach B), or
- Fulfilment of economically separable performance obligations under the contract (Approach C).

Under the continuous approach, revenue is recognised continuously in the course of the contract as the entity performs towards the fulfilment of its contract obligation. According to this approach, measures of contract progression (i.e. entity performance) must be defined.

The adoption of both approaches, the critical events approach and the continuous approach, is in our point of view not equally suitable for all types of transaction in all industries.

2.1. Critical Events Approach

Revenue recognition upon fulfilment of all contractual performance obligations is a simple concept that would be suitable with a widely held view for most kinds of transactions.

The approach is most suitable for short-term contracts which are encountered in industries characterised by mass production and a large number of homogeneous revenue transactions such as the production and sale of consumer goods, where no additional features such as (financial) services as part of a multiple element arrangement are provided.

Multiple-element arrangements and long-term contracts, in contrast, ask for a revenue recognition approach that considers the fact that parts of the contractual performance obligation are fulfilled as certain thresholds or milestones are reached. These thresholds either may be explicitly specified in the form of part-contracts (Approach B) or identified using objective economic criteria (Approach C). Specific agreements on part-contracts may not always reflect the economic substance of a performance obligation, furthermore revenue recognition could be influenced at the discretion of the parties to the contract.

Approach C could therefore be developed to work for long-term, multiple-element and short-term transactions. However, segregation of contracts into individually identifiable performance obligations must be limited to those transactions that provide more than one identifiable separate value to the customer. How this value is defined would ultimately have to be determined considering the characteristics of different transactions and possibly different industries.

2.2. Continuous Approach

With a large number of separately identified performance obligations the critical events approach (Approach C), would result in a comparable pattern of revenue recognition compared to the continuous approach. However, in contrast to the critical events approach, revenue recognition under the continuous approach is based on an entities' individual performance progress rather than on fulfilment of objective part performance obligations.

We see the continuous approach as being suitable for some industries with for example continuous performance obligations. However, it would be less suitable to reflect revenue recognition for short-term contracts and revenue-generating transactions that have a variable term, e.g. value adding chains that starting from raw material produce large quantities of a product and –if the customer asks for it- might include financial services. For these transactions, the continuous approach would increase complexity without creating additional value to the readers of financial statements. Since it must be widely based on assumptions and subjective judgement information would possibly even become less useful for financial statement users as a basis for decisions.

To illustrate the impact of a continuous approach to transactions other than long-term contracts consider a manufacturer of consumer goods that produces and sells its products and offers financial services to support its sales:

Only part of the goods produced are built to order, i.e. at the time of the production a customer contract exists already, for the other part there is no such contract. The manufacturer would then have to separate its production into contract-related and non-contract-related units. In cases where order backlogs exist, an additional distinction would have to be made for contracts for which sufficient quantities are on stock to fulfil the order and binding orders for which the respective quantities are not yet produced.

For contract-related units and order backlogs, the manufacturer would have to define the moment in its production process in which the production is sufficiently appropriated to the contract as a starting point for revenue recognition.

Consequently, criteria to measure the progress towards fulfilment of the performance obligation have to be defined. This does not only require an integration of production planning and accounting that is currently not in place, it would also be widely based on assumptions and judgement by the preparers of financial statements.

Revenue figures would become even less reliable in cases where the term and content of a contract with a customer is subject to changes. For example, a customer who orders a passenger car can upon delivery of the vehicle decide whether to pay in cash, have the purchase price financed by the manufacturer's finance affiliate, or enter into a lease arrangement with the finance affiliate that may or may not transfer the substantial risks and rewards of ownership to the customer. These changes in the contract term are very common in the automotive industry, and they would inevitably result in frequent retrospective adjustments of already reported revenues.

Monitoring the production process as well as possible order backlogs requires an integration of accounting and production planning. This and the fact that different patterns of revenue recognition would have to be reflected for quantities that are built to order, for those built to stock and for contracts not covered by existing quantities would increase accounting complexity significantly without generating more reliable revenue numbers. Quite the contrary, users of financial statements would be faced with revenue figures that are widely based on assumptions and judgement on the side of the statements' preparers. The information on entities' revenue would hardly be understandable without detailed knowledge of the entity's individual production process. We therefore believe that with respect to the criteria of decision usefulness and comparability the continuous approach if applied to transactions other than continuous performance obligations is a step backwards as it increases complexity and at the same time reduces reliability.

3. Conclusions

From a user's perspective, revenue recognition should be based on objective criteria that are for financial statements of different entities in different industries comparable and understandable. Applying the continuous approach to all revenue generating transactions would not only increase complexity in preparing financial statements but also at the same time reduce reliability and comparability of revenue numbers presented.

We do not believe that one single approach to revenue recognition will suffice. Indeed, we believe the current provisions of IAS 18 and IAS 11, with minor amendments to address continuous performance obligations and multiple-element arrangements will cover the issues currently identified.

Yours sincerely,

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