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By email: ong@hkicpa.org.hk & by post

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Exposure Draft – Revenue from Contracts with Customers

Dear Steve:

We refer to your letter dated 29 June 2010 and would like to set out our comments on the International Accounting Standards Board's Exposure Draft – Revenue from Contracts with Customers.

Our comments on the specific questions raised in the exposure draft are attached. We would be happy to further clarify or discuss any of the above points should you so wish.

Yours sincerely,

Rita Liu
Secretary

Enc.

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Vice Chairmen Bank of China (Hong Kong) Ltd
The Hongkong and Shanghai Banking Corporation Ltd
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**Response to Specific Questions in the International Accounting Standards Board's
Exposure Draft ED/2010/6 Revenue from Contracts with Customers**

Recognition of Revenue

Question 1

Paragraphs 12 – 19 propose a principle (price interdependence) to help an entity determine whether:

- (a) to combine two or more contracts and account for them as a single contract;
- (b) to segment a single contract and account for it as two or more contracts; and
- (c) to account for a contract modification as a separate contract or as part of the original contract.

Do you agree with the principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

We generally agree that price interdependence should be the criteria by which contracts are combined and that price independence should be the criteria by which contracts are segregated. However, we believe that additional clarification is necessary in determining when price interdependence exists. In addition, we have concerns that the requirements of the ED will require significant judgment to implement and may result in significant variation among reporting entities without additional clarification.

Paragraph 13 provides indicators that two or more contracts have interdependent pricing. We believe that the factors presented are less indicative that interdependent pricing exists than that interdependent pricing might exist and further analysis is necessary. The paragraph should be clarified accordingly.

We believe that interdependent pricing results from two or more contracts entered into in contemplation of each other (which the criteria in paragraph 13 would indicate) and that one or more contract(s) has been priced at a discount that is compensated for by the pricing on the other contract(s). This would be consistent (although inversely) with the concept of independent pricing as described in paragraph 15, which requires that a discount has not been provided when selling goods or services together. We believe that the combination of contracts for revenue recognition purposes should occur only when there is objective evidence that one or more contracts within a group is priced below fair value and the economic rationale for that discount can only be explained by reference to the pricing on another contract(s) in the group.



Question 2

The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised goods or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

While we do not have a conceptual disagreement with the guidance regarding identifying specific performance obligations, we have significant concerns regarding the practical application of this guidance to the financial services industry.

Currently, financial institutions offer retail and commercial customers a variety of service options in connection with depository relationships (such as checking, ATM access, electronic banking, bill payment, and related services). In most cases, the fees charged are dependent on the level and scope of services offered as well as the amount of cash maintained on deposit. In some cases incremental services (e.g., cashier checks, foreign ATM fees, etc.) are not separately charged for or are charged at an amount different from other service packages or a stand alone service fee. Industry practice is to recognize any associated fee when the fee becomes due and payable. Therefore, monthly checking/current account fees are recognized when due from the customer and incremental fees, such as ATM fees, are recognized when the transaction occurs.

Credit card services exhibit many of the same characteristics as depository relationships. In many instances, credit card services are essentially transaction processing services because the financial institution is not advancing funds to the customer when the customer pays its monthly charges in full. In addition to transaction processing, credit card relationships often involve the provision of a number of other services at the option of the customer (e.g., travel related, advisory, concierge services, etc.) These services may be priced separately at amounts below a stand alone price or provided at no additional charge when an annual fee is assessed or in contemplation of earning interest on those customers who ultimately do borrow funds from the financial institution.

Our specific concerns are as follows:

I. Revenue Recognition on Fee Based Depository/Credit Card Relationships:

While many depository services are provided only in connection with depository relationships (e.g., check processing, electronic banking, etc.), there are other services offered within a depository relationship that are also provided separately to customers at a stand alone price. This also applies to credit card relationships. Accordingly, we believe that separately offered services could be viewed as distinct services under paragraph 23 of the ED and require being accounted for as separate performance obligations. For financial institutions providing depository and credit card services, a requirement to allocate a transaction price among the



various services would be impractical and would not provide useful information to users of financial statements.

We also note that there exists an inconsistency between paragraph 20 of the ED which requires an entity to identify performance obligations based, in part, on an entity's customary business practices. However, paragraph 23(a) indicates that a performance obligation is distinct (and thus requires separate accounting) if the entity, or another entity, sells an identical or similar good or service separately. Whether another entity sells an items separately is not related to the reporting entity's customary business practice and would require an impractical level of due diligence to determine whether any other entity sells an item separately.

Many of the services provided in depository and credit card relationships require the financial institution to stand ready to provide such service (e.g., ATM services). The services would be utilized at the option of the customer. Paragraph B87(b) of the ED would require a reporting entity to estimate the likelihood that the option will be exercised in estimating the amount of the transaction price to allocate to that performance obligation. Given the number of services offered by financial institutions, it would not be practical to develop reasonable expectations of utilization of every service offered within a depository relationship.

Nearly all depository relationships represent contractual obligations that renew on a continuous basis and require that a fee be paid monthly to the extent that a fee is charged. One view on the application of the ED could be that the monthly service fee is compensation for the customer's option on a menu of services and that option expires monthly. Therefore, revenue would be recognized monthly based on the fee charged.

However, paragraph B88 of the ED discusses options to acquire additional goods or services that provide the customer with a material right and that, typically, those types of options are for contract renewals. The option to continue the depository relationship (whether contractually present or based on past practice or economic compulsion) could be viewed as a material right to the customer if the customer is expected to utilize more services in the future as the customer becomes more familiar with the offered services, or the customer's needs change or service offerings improve (e.g., increase in the number of ATM machines available). Paragraph B25 of the ED states that if the option provides a material right, the customer in effect pays the entity in advance for future goods or services and the entity recognizes revenue when those future goods or services are transferred or when the option expires. (This would be consistent with Example 27 in the ED which addresses maintenance contracts with a renewal option.)

In regards to options, we note that the definition of performance obligations in the ED includes both options and standing ready to provide goods or services,

which would typically be done in connection with issuing an option. We believe this creates confusion as to whether the revenue associated with issuing an option should be recognized ratably over the period in which the entity stands ready or when the goods or services are delivered as contemplated by paragraph B25.

Credit card relationships would typically involve an annual fee that would compensate for the provisions of services across multiple reporting periods. Thus, the allocation of credit card fee revenue to performance obligations in future reporting periods would need to be considered regardless of any consideration related to renewal options.

Paragraph 50 of the ED requires that an entity allocate the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the good or service underlying each of those performance obligations at contract inception (i.e., on a relative stand-alone selling price basis.) Paragraph 34 of the ED requires that when an entity satisfies a performance obligation, it shall recognize as revenue the amount of the transaction price allocated to that performance obligation. Allocating monthly fees across all performance obligations would require significant system enhancements to identify all cross service relationships and track the associated revenue. Given the costs of such enhancements, it is possible that at least some financial institutions would reduce the menu of service options available rather than deal with the related accounting burden.

2. Onerous Performance Obligations

Many services provided to customers under a depository relationship are provided at no additional charge or at a reduced price because of the benefits to the financial institution of obtaining low cost funding from the customer deposits. For relationships in which the customer is not charged, a question arises as to whether the accounting for the contract is within the scope of the ED or IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. Paragraph 10 of the ED identifies criteria for identifying whether a contract exists for the purpose of applying the revenue requirements of the ED. Those criteria include whether the entity can identify the terms and manner of payments for those goods or services. It is not clear whether those criteria apply to the requirements in paragraph 54 of the ED to recognize a liability for an onerous performance obligation or that such an arrangement is not a contract within the scope of the ED.

The measurement of a potentially onerous contract liability could differ depending on whether the provisions of the ED or IAS 37 is applied. Under the ED, a performance obligation is onerous if the present value of the probability-weighted costs that relate directly to satisfying that performance obligation exceeds the amount of the transaction price allocated to that performance obligation. Transaction price is defined in the ED as the amount of consideration that an entity receives, or expects to receive, from a customer in exchange for

transferring goods or services, excluding amounts collected on behalf of third parties (for example, taxes). Currently, IAS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. While IAS 37 would take into consideration the economic benefits of the deposits to the financial institution, the ED would appear to result in such a depository relationship being an onerous contract based on the pricing associated with the contract (which would often be nil) as opposed to the overall economics of the relationship. Also, the definition of probability weighted costs under the ED is different than the definition of unavoidable costs under IAS 37.

We support the objective of creating a single revenue recognition model for all contracts with customers and believe that financial services (other than in regards to financial instruments) should be incorporated into that model. However, based on our observations discussed above, we believe that certain changes and clarifications, as follows, to the proposed revenue recognition model are necessary to make the proposed standard operational for financial services entities:

- a. The definition of distinct in paragraph 23 should allow that a menu of similar but distinct products or services provided in exchange for a bundled price represents a single performance obligation when (i) customers have the option to take/use or not take/use any of the goods or services; and (ii) it is not practical to determine either the probability of usage or the amount of usage that would be allocable to each period within the contract term including any renewal options. Revenue should be allocated ratably over the contract period where the cost to meet the single performance obligation (i.e., menu of goods or services) are primarily based on a standing ready to do so basis.

We believe that this would be consistent with the concept of control in that the customer initially obtains control upon receipt of the option over the menu of services. For example, when a customer receives a debit card, they then control the use of ATM services and that control is transferred to the customer continuously over the term of the depository relationship as the financial institution stands ready to service the customer. The actual performance of many of the obligations related to a depository or credit card relationship would generally incur little incremental cost; rather, costs are typically incurred in connection with standing ready to provide such services, which is done ratably over the contract period consistent with the transfer of control. Therefore, where the fee is a fixed monthly amount, revenue recognized in a period would be equal to the number of months in a period multiplied by the fixed monthly fee.

The concept of similar products and services would not include reward programs offered with other financial services, as we believe that reward

programs are fundamentally different in nature than the provision of financial services such as ATM, check cashing, etc.

- b. The definition of onerous contract should be revised to require a comparison of the expected costs against the economic benefits of the contract rather than the price of the contract. Otherwise, contracts that have positive economic benefits to an entity will be treated as onerous thus creating a mismatch between revenues and expenses. In addition, the scope of the ED and IAS 37 in regards to onerous performance obligations should be clarified.
- c. The ED should provide examples applicable to depository and credit card relationships that demonstrate the principles in the ED and that reflect our concerns and comments.

Question 3

Do you think that the proposed guidance in paragraphs 25 – 31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

The ED proposes a revenue recognition model whereby the trigger for recognition of revenue is based on whether the customer has obtained control of the goods or services. Paragraph 26 of the ED states that a customer has obtained control of a good or service when the customer has the ability to direct the use of and receive the benefit from the good or service. Under IFRS 18, revenue on service contracts is recognized based on, in part, whether the stage of completion, the costs incurred and costs to complete a transaction can be measured reliably.

In regards to service revenue, the ED moves the trigger for revenue recognition away from the provider of the services to the consumer of the services. Given that revenue is intended to reflect benefits that flow to the reporting entity, we believe that the current trigger is more appropriate than that proposed in the ED. In addition, control over services is a tenuous concept that will be difficult to apply in practice. Requiring that the customer have both the ability to direct the use of services and receive the benefits is particularly problematic. Whether a customer benefits from services should be ascertainable. However, in many cases a customer may have little ability to direct the use of services particularly when those services are provided by experienced professionals with particular expertise. Consistent with our view in Question 2 that the customer initially obtains control upon receipt of the option over the menu of services, we believe the criteria for revenue recognition of services should be based on whether the provider of services can reliably measure the extent to which it has fulfilled its obligations.

Measurement of Revenue

Question 4

The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?

The ED proposes in paragraph 35 that the transaction price be derived from the probability-weighted amount of consideration that an entity expects to receive from the customer in exchange for transferring goods or services. However, in paragraph 38 the ED states that an entity shall recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. We find these statements to be in conflict with each other. The use of multiple probability-weighted scenarios would indicate that a transaction price cannot be reasonably estimated unless there is a single scenario that carries a very high probability of occurrence, in which case we see no value to using multiple probability-weighted outcomes.

The proposals would result in the introduction of a significant amount of subjectivity in revenue recognition, resulting in increased volatility in revenues and reported income and reduced comparability among entities. The amount of revenue reported would not be reflective of management's best estimate but rather an amount derived based on multiple scenarios that have been assigned a probability that in practice will often be arbitrary. For example, estimating the probability of a refund to a customer when recognizing revenue if the customer has a right to return the product transferred or assessing the probability of exercising the option for maintenance services with a renewal option would both require significant amounts of judgment.

The current revenue recognition criteria under IAS 18 requires that revenue be recognized when, among other criteria, it is probable that the economic benefits associated with the transaction will flow to the entity and the amount of economic benefits can be reliably measured. We believe that these two criteria result in the recognition of revenue when there is a high level of confidence that some amount of consideration has been earned and that amount can be calculated without material error. This is also consistent with paragraph 4.48 of the Conceptual Framework for Financial Reporting 2010 (the "Conceptual Framework") which states: "The procedures normally adopted in practice for recognizing income ... are generally directed at restricting the recognition as income to those items that can be measured reliably and have a sufficient degree of certainty."

We believe that the measurement criteria in the ED should be revised to be consistent with current practice under IAS 18 – probable that revenue has been earned (i.e., high level of confidence which we believe is a threshold greater than more likely than not) and the amount can be reasonably estimated. This will result in reported revenue that reflects an amount based on management’s best expectations that will frequently be correct rather than a hypothetical outcome that will always be incorrect.

Question 5

Paragraph 43 proposes that the transaction price should reflect the customer’s credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer’s credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue? If not, why?

We do not believe that credit risk is relevant to the amount of revenue that should be recognized. However, in some cases, credit risk is relevant as to whether the criteria for revenue recognition has been met. Paragraph 10 of the ED defines when a contract exists, which requires that the parties to the contract are committed to satisfying their respective obligations. If there is significant uncertainty as to an individual customer’s ability or willingness to pay, revenue should not be recognized until which time that uncertainty is resolved because the provision of goods and services in the face of significant credit risk calls into question whether a contract exists. However, we do not believe that the presence of unspecified credit risk in a group of financial assets indicates that a contract does not exist.

The initial valuation of an originated financial instrument (i.e., receivable) should be independent of the revenue recognition criteria as they are in essence two different transactions – selling goods or services and lending. The principle for the treatment of credit losses should be consistent regardless of whether a receivable arises as a result of a sale transaction or a pure lending transaction. The determination of the amount of impairment of a group of receivables should be dealt with consistent with the accounting for other financial instruments and, in our view, should result in the recognition of bad debt or impairment expense rather than a reduction of revenue or interest income.

Question 6

Paragraph 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

We agree that a trade receivable should be recorded at a discount if there is a material financing component. The discount should be a reduction of revenue because implicitly the transaction price for the contract would reflect compensation for the time value of

money in addition to the performance obligation. We believe that there should be a rebuttable presumption that the financing component for a receivable with an original maturity of less than one year is not material.

Question 7

Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

We agree that the stand-alone selling price is an appropriate basis on which to allocate the transaction price. The stand-alone selling price will often approximate the fair value of each performance obligation; consequently, allocation based on stand-alone selling price is comparable to a relative fair value method which would be common in current practice. However, we suggest that the IASB should clarify whether a stand-alone selling price would be based on standard pricing or average stand-alone selling prices actually contracted with customers or any other basis.

Contract Costs

Question 8

Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 389 Intangible Assets or ASC Topic 985 on software), an entity should recognize an asset only if those costs meet specified criteria.

Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?

We believe that the criteria are operational.

Question 9

Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

The costs to be expensed under the proposal include costs of abnormal amounts of wasted material, labor or other resources used to fulfill the contract. These items are appropriately expensed in the context of accounting for physical inventory held for sale, whereby standard costs are developed for each item against which actual costs can be compared. Capitalization of such abnormal costs would otherwise often result in inventory that is carried above net realizable value. However, in the context of services, we do not believe that such costs should be expensed as incurred because such costs would be nearly impossible to identify with any reasonable level of accuracy given that most service contracts relate to unique deliverables. The criteria in paragraph 57(c) that costs to be capitalized must be expected to be recovered adequately ensures that only assets with realizable value are recorded.

Disclosure

Question 10

The objective of the board's proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

Paragraph 69 of the ED states that an entity shall disclose qualitative and quantitative information about: (a) its contracts with customers and (b) the significant judgments, and changes in judgments, made in applying the IFRS to those contracts. Paragraph 71 states that if the disclosures provided in accordance with this IFRS and other IFRSs do not meet the objective in paragraph 69, an entity shall disclose whatever additional information is necessary to meet that objective. We are concerned that the objective in paragraph 69 is so broad that it is not clear what level of disclosure would meet the criteria in paragraph 71. The disclosure requirements in paragraphs 73 – 83 require extensive disclosures. We do not believe that this additional ambiguous requirement in paragraph 71 is warranted.

In addition, paragraph 77 requires extensive descriptions of performance obligations. To comply with the ED, an entity is required to decompose each transaction into different performance obligations by their distinct function and profit margin. It would be very cumbersome and time-consuming to compile such disclosures, and impractical for an entity to present this kind of information at this volume in a concise and understandable manner. Disclosing too much (or even redundant) information will not provide meaningful information to users of financial statements. Finally, the cost of compiling extensive disclosure may outweigh the potential benefits generated from information disclosed. We believe that the amount of information required to be disclosed should be reconsidered by the Board.

Question 11

The boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

The scope of the ED is very broad and includes long-term construction type contracts and other service contracts. Enhanced disclosures, consistent with current practice, may be appropriate for long term construction contracts where there is a need to reconcile revenues, contract assets, contract receivables, deferred revenue, etc. However, to apply the disclosure requirements to all types of service contracts would be onerous and not meaningful. It may be impractical for an entity to ascertain the amount and timing of satisfying performance obligations for contracts such as distribution agreements where the sales volume and timing of sales may depend on the market environment, which is not under the entity's control. Arbitrary estimates may ultimately be misleading to users of the financial statements.

Question 12

Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

The IASB currently has on its agenda a project on financial statement presentation. We believe that all proposed changes to the face of the financial statements should be addressed in the financial statement presentation project.

Question 13

Do you agree that an entity should apply the proposed requirements retrospectively (ie as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

If revenue is not recognized on a consistent basis, then comparative financial statements are essentially meaningless. Therefore, we generally agree that the proposed requirements should be applied retrospectively. However, any change to the revenue



recognition criteria would involve a significant amount of work both in regards to scope of activities and systems enhancements that would be necessary for many entities. We recommend that the effective date of any IFRS be at least three years from the date on which the final standard is issued to allow entities to process revenue under parallel systems and not be forced to reassess historical transactions. In addition, we have concerns regarding the retroactive application to long-term contracts, which might require the preparer to recalculate revenue for a number of years prior to the earliest date presented in the financial statements in order to appropriately calculate revenue for the periods presented. The Board should consider special transition provisions for those types of contracts.

Application Guidance

Question 14

The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

Example 13 provides a scenario of the sale of goods with delivery terms FOB shipping point and where the seller has a practice of covering any risk of loss during shipment despite a lack of legal obligation to do so. The example concludes that revenue would be recognized because the FOB shipping terms indicate that the customer has title to the goods and therefore controls the goods (e.g., can onward sell the goods); some revenue should be recognized on the shipment of the goods and some upon delivery because the provision of loss coverage represents an additional performance obligation.

This example demonstrates the difficulty of applying a control concept to revenue recognition. The example assumes that the passage of risk of loss necessarily transfers title and thus control over the goods, such as the ability to onward sell the goods. (What if the goods have shipped under FOB shipping point terms but the customer has not yet received the bill of lading or documents of title – can the customer onward sell the goods in a practical manner?) We object to an accounting standard that is premised upon a legal analysis. How and when title transfers might differ based on the legal jurisdiction and the form and manner of the transaction. We believe that if the control concept is maintained that an indicator of control should be based on whether the majority of the risks and rewards of ownership have passed (which are generally discernable based on shipping terms, which would indicate risk of loss, and any other contract terms) rather than on whether title has been transferred, which in some circumstances might require legal consultation.

Question 15

The boards propose that an entity should distinguish between the following types of product warranties:

- (a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.
- (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specific in the contract.
- (c) Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

We do not object to the proposed distinction because in most cases the provision of a warranty for faults that arise after the product is transferred is separately priced in the transaction. We believe that current practice for recognizing product warranty liabilities, which is typically based on historical experience, is consistent with the requirements in the exposure draft to estimate product returns requiring repair or replacement.

Question 16

The boards propose the following if a license is not considered to be a sale of intellectual property:

- (a) if an entity grants a customer an exclusive license to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the license; and
- (b) if an entity grants a customer a non-exclusive license to use its intellectual property, it has a performance obligation to transfer the license and it satisfies that obligation when the customer is able to use and benefit from the license.

Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

We do not believe there is a strong conceptual basis for treating differently exclusive versus non-exclusive licensing rights. While an exclusive license requires the licensor to

refrain from further selling the license, we do not believe that the obligation to refrain from doing something (something that would represent a contractual violation) should be viewed as a performance obligation. Exclusive licenses will often have limited contract periods over which revenue could be allocated; however, non-exclusive licenses are often sold as perpetual licenses making it impractical to allocate revenue over future periods. Given that we believe that no distinction should be made between exclusive and non-exclusive rights, revenue should be recognized upon transfer of the license to the customer as this is when the seller has met its obligations (excluding immaterial maintenance) and the customer has gained control and has the ability to determine the extent of future use of the product.

Consequential Amendments

Question 17

The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

If additional guidance is provided, we believe that the criteria in the ED for revenue recognition could be applied to gains or losses which are derived from sales of some non-financial assets such as intangibles and property, plant and equipment. There may be issues associated with such transactions, such as seller financing or retention of certain risks and rewards, that make such transactions more complicated than sales in the course of an entity's ordinary activities. The proposed IFRS would need to contemplate such issues as well as any changes that might be necessary to other IFRS which address such transactions.

In addition, the definition of revenue in the ED, which is income arising in the course of an entity's ordinary activities, would need to be revised as the transactions contemplated may or may not arise in the course of an entity's ordinary activities. This would be consistent with the Conceptual Framework, which states in paragraph 4.30 that gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity; hence, gains are not regarded as constituting a separate element in the Conceptual Framework.