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Mouvement des Entreprises de France
MEDEF

A F E P

Association Française des Entreprises Privées

EFRAG
13-14 Avenue des Arts
1210 Brussels
Belgium

Paris, January 07, 2008

Re: *PAAinE "Revenue recognition – a European contribution"*

ACTEO, AFEP & MEDEF welcome the opportunity to comment on the EFRAG paper presenting "Revenue recognition – a European contribution". ACTEO, AFEP & MEDEF fully support EFRAG in developing European views that could influence the IASB standard setting process.

We concur with the EFRAG that a comprehensive debate around revenue recognition is needed, and would like to stress that the paper has reached one of the goals assigned to it, that is to stimulate debate. Views have been actively debated among ACTEO, AFEP & MEDEF's members on each of the approaches to revenue recognition developed in the paper. The outcome of the passionate debate is that it is not necessary to undergo a major change in accounting for revenue recognition because there are different economic situations that can not be faithfully represented with a single one of the approaches developed by EFRAG. Moreover, ACTEO, AFEP & MEDEF believe that there are not two different principles in the current standards (as explained in response to question 1), but that an exception has been designed to address the construction contracts characteristics.

We are however concerned with the inconsistencies that currently exist within the existing requirements and wish to address these in priority rather than develop a revolutionary concept for revenue recognition or change completely the way revenue is recognised at present.

Revenue recognition is a very critical issue in the financial communication of the companies. The definition of revenue is the starting point of the debate and should give a clear understanding of what kind of activity is portrayed in the statement of income. ACTEO, AFEP & MEDEF think that the definition of revenue proposed by EFRAG is not fully satisfactory because the notion of contract has not been comprehensively explained and because the "gross inflow" notion included in the definition (see our response to question 3) doesn't seem to encompass principal/agents relationships, which are also an important pattern of economic situations.

The document explores different approaches to revenue recognition but does not provide enough analysis of the consequences of the approaches on assets and liabilities. ACTEO, AFEP & MEDEF believe that asset increases or liability decreases should have been explored further in order to define what kind of assets or liabilities are involved or linked to revenue recognition. Not including these in the scope of the study is a weakness that has not permitted to conclude whether transfer of risks and rewards is an attribute to asset derecognition or to revenue recognition.

At last, we would like to pinpoint that EFRAG's assessment of the continuous approach as a possible unique principle applicable to all businesses remains theoretical, as the continuous approach would be for some businesses extremely costly to implement for a benefit to users yet to be defined.

EFRAG has stimulated debate around revenue recognition from the standpoint of the necessary conditions to fulfil in order to recognise revenue, where the IASB has started thinking on measurement of revenue recognition. The two discussions are complementary and ACTEO, AFEP & MEDEF suggest that EFRAG proposes to the IASB to bring the two aspects of the thinking together. This would allow a comprehensive discussion on all the aspects of revenue recognition.

Should you wish any supplementary comment or explanation, please do not hesitate to contact us.

ACTEO	AFEP	MEDEF
Patrice MARTEAU Chairman	**Alexandre TESSIER** Director General	**Agnès LEPINAY** Director of economic and financial affairs

Q1 *It is stated in the discussion paper (paragraphs 1.4 - 1.10 and Appendix II) that there are weaknesses in the IASB's existing revenue recognition standards, IAS 11 and IAS 18. In particular, the standards do not address certain types of transaction (for example they say little about multiple-element arrangements), they are based on different principles (which leads to inconsistencies and uncertainties and makes it difficult to know how to use the standards to fill the gaps) and there are internal inconsistencies within IAS 18. The paper goes on to say that these gaps, inconsistencies and uncertainties are causing real practical problems. Do you think these comments about the existing standards are fair ? (If you do not, could you please explain which comments you think are not fair and why.) Do you have any additional concerns about existing standards ? (If you do, please could you explain them).*

ACTEO, AFEP & MEDEF agrees that there are inconsistencies between IAS 18 and IAS 11 which need to be addressed but ACTEO, AFEP & MEDEF does not believe that the existing literature is being built on two distinct competing principles. The overriding principle in the existing literature requires that revenue recognition follows transfer of risks and rewards to the customer. Two situations arise :

1- Either the transfer of risks and rewards coincides (more or less) with completion, and revenue is recognised upon completion,
2- Or the transfer of risks and rewards occurs continuously, and revenue is recognised progressively.

One exception to that overriding principle has been introduced for construction contracts, because applying this overriding principle to such activities did not lead to useful and relevant financial information for users.

Q2 *Paragraph 1.20 states that the objective of the paper is to develop a framework within which to address revenue recognition issues in a consistent way. Paragraph 1.26 explains further that the ultimate objective of the revenue recognition debate should be to develop a set of principles that can be applied to all kinds of industries and business. In other words, rather than have different, competing principles like we do now, we would have a single principle or a single set of principles that apply generally and can be used to address any future gaps in standards.*

(a) Do you believe this is an appropriate and realistic objective ? (If you do not, please could you explain your reasoning and what you believe is an appropriate and realistic objective.)

(b) Although the objective is to develop principles that can be applied to all kinds of industries and businesses, the paper does not explore sector-specific issues in any detail ; the analysis and discussion is generic and not based on any particular sector. (For example, the paper's only reference to financial institutions is to note, in paragraph 1.26, that banks and insurers do not present a revenue number and to observe that it is outside the scope of the paper to consider whether such entities should present a revenue number and what such a number should represent were it to be provided.) Do you believe this approach is appropriate ? If you do not, please could you explain which sector specific issues the paper should explore and why you think that would improve the quality of the analysis.

ACTEO, AFEP & MEDEF agrees that the existing literature needs some revisiting. However ACTEO, AFEP & MEDEF does not believe that the improvements needed should in any way and for any business radically change revenue recognition present practices.

We agree that guidance is needed for dealing with multiple deliverable contracts for which IFRS guidance is very limited, but we are not convinced that the approaches developed in the paper would allow consistent accounting for these operations among businesses.

We believe that the scope of the exception made for construction contracts is not necessarily designed to ensure the most relevant financial information in all circumstances and that progress should be made in this area.

ACTEO, AFEP & MEDEF believes that revenue recognition principles should lead to some useful and relevant information for users. In ACTEO, AFEP & MEDEF's view, a useful and relevant revenue number is a number which reflects the level of business activity of the entity in the period pursuant to commercial success and is based on as objective a measurement as possible.

Q3 *Chapter 2 of the paper discusses what revenue is. It does so by examining what the Framework says about revenue (paragraphs 2.5 - 2.13) and what other attributes revenue should have (paragraphs 2.14 - 2.33). It concludes that :*

(a) Revenue is a particular type of increase in assets or decrease in liabilities.

(b) Revenue is a gross notion. In other words, if an entity sells an item for €10, making a profit of €2, it will be the €10 rather than the €2 that will be recognised as revenue.

(c) Revenue does not necessarily arise only from enforceable rights and obligations.

(d) Revenue is some sort of measure of activity undertaken pursuant to a contract with a customer. Therefore, without a contract there can be no revenue. Furthermore, revenue will not arise simply from entering into the contract, because at that point there will have been no activity undertaken by the supplier pursuant to the contract.

(e) Revenue does not necessarily involve an exchange.

(f) Revenue is something that arises in the course of ordinary activities.

(g) On the basis of the conclusions summarised above, a working definition of revenue is that revenue is the gross inflow of economic benefits that arises as an entity carries out activities pursuant to a contract with a customer. Do you agree with these conclusions ? (If you do not, please could you state which conclusion you do not agree with and explain your reasoning.) Do you believe that revenue has some additional attributes that should have been referred to ? (If you do, please could you describe those additional attributes and explain your reasoning ?)

We agree broadly with the definition of revenue proposed in the EFRAG discussion paper. However we wonder whether the reference to a contract with a customer belongs to the definition ; we also believe that the reference made to "a contract with a customer" needs to be refined and explained and that the notion of "gross" inflows needs to be further analysed:

- In the existing framework, revenue is the gross inflows of income which an entity derives from its business activities ; the framework states that revenue is recognised when it is "reasonably certain" ;

- As a result, we understand the existing definition as intending that the probability criterion for recognition be met and question whether a recognition criterion belongs to the definition ;
- Furthermore, we wonder whether the necessary existence of a contract with a customer is intended to ensure that the revenue is "reasonably certain" or whether some other notion is implied ; the degree of enforceability reached in the contract should therefore be discussed ; a situation in which goods are delivered on a liquid market needs also to be addressed (ex: gold mining activities) ;
- We also believe that the assets and liabilities generated by a customer contract should be described, in order to ensure that revenue (defined as increase in assets and decrease in liabilities pursuant to a customer contract) is well understood ; we observe that adopting the continuous approach to revenue in all circumstances would suggest that the increase in asset that is recognised as revenue is not an increase in a right to consideration, but rather some form of WIP valued on the basis of the price agreed in the contract (as long as the right to consideration remains contingent on the seller performing in full in accordance with the contract terms) ; we would like to stress that in the context of a continuous approach we believe that the conditions in which derecognition of assets and liabilities can take place are important economic events that should be reflected in the financial statements. We however believe that the derecognition of a WIP (valued on the basis of the price agreed in the contract) could give rise to a receivable, without any flow being captured in the income statement ;
- We welcome the reference to "inflows", focusing on the first line in the income statement ;
- We believe however that the notion of gross inflows should be refined in order to encompass agency relationships and businesses in which only a net inflow is relevant (for example, loan activities in a bank generate an interest margin, and the gross inflows (interest income) is not the relevant number, as it is too heavily influenced by variations in interest rates).

Q4 *As mentioned in Q3 (d), revenue is some sort of measure of activity undertaken pursuant to a contract with a customer. However, the paper's analysis is not conclusive as to exactly what "sort of measure of activity" revenue measures; it could for example be a measure of completion activity (in other words, a measure of the things the supplier has completed) or a measure of activity towards completion (in other words, a measure of the things the supplier has done under the contract). This issue arises again and again in the paper and is the main issue that separates the critical event approaches discussed in Chapter 3 from the continuous approaches discussed in Chapter 4. The authors believe that a very important test of any proposed accounting solution is whether it is the most useful approach from a user perspective. Which activities do you believe the revenue number should measure : completion, or activity towards completion ? Or are there other alternatives that need to be considered ?(Please give your reasons for the answer you have given.)*

We observe that the various approaches are analysed as to whether they solve the difficulties raised in practice by IAS 18 and IAS 11. We regret that these various approaches are not analysed to determine whether and how each of them is likely to provide useful information to users of financial statements.

Q5 Chapter 3 discusses when revenue arises and, in doing so, introduces various critical event approaches to revenue recognition and explores three of them (Approaches A, B and C) in detail.

(a) Do you believe the discussion of Approaches A to C is fair and complete ? For example, do you believe that one of the approaches has some additional benefits or weaknesses that have not been mentioned ? Or that some of the weaknesses mentioned are not weaknesses ? (If you do, please could you explain what you think is unfair and incomplete about the discussion, together with your reasoning.)

(b) Do you believe there are any critical event approaches other than Approaches A to C that have merit and are worth exploring in greater detail ? (If you do, please could you describe those approaches and explain why you think they are worth exploring further).

ACTEO, AFEP & MEDEF believes that, as experience has demonstrated in the past, keeping the overriding objective as it is today, i.e. revenue recognition coinciding with asset derecognition, will not lead to useful and relevant information in all circumstances. ACTEO, AFEP & MEDEF further believes that revenue recognition based on asset derecognition provides relevant information in businesses in which goods delivered are rather fungible and produced in large quantities. However ACTEO, AFEP & MEDEF believes that such a proxy for the measurement of an entity's activity in a period will not necessarily (although it may in some circumstances) provide relevant and useful information in businesses where one or several of the following features are met:

a. There is a long lead time between the contractual agreement and completion of the asset to be delivered

b. Assets being delivered are heavily customised

c. Assets being delivered are sold in very small quantities

As a result, ACTEO, AFEP & MEDEF believes that two different patterns of revenue recognition remain needed.

***Q6** Chapter 4 continues the discussion of when revenue arises by introducing and exploring another type of approach to revenue recognition: the continuous approach*

(Approach D). Again, do you believe the discussion is fair and complete ? (If you do not, please could you explain what you think is unfair and incomplete about the discussion, together with your reasoning.)

ACTEO, AFEP & MEDEF believe that the conclusion reached in the EFRAG document, i.e. that the continuous approach holds a chance of solving the issues at stake would remain at best theoretical. Indeed, even though the continuous approach would be adopted as overriding principle in the future, designing the boundaries of an exception would still be needed. This is because ACTEO, AFEP & MEDEF observe that, for some businesses, relevance issues being set apart, the cost/benefit trade off would remain very favourable to adopting a revenue recognition approach based on asset derecognition. Such an approach cannot therefore be eliminated. For those businesses, revenue recognition based on a continuous approach would not bring better information and yet would be very costly. We note the similarity with the IAS 23 exception applying to inventories carried in large quantities (the information provided to users is as useful and far less costly than it would be, would the general principle be applied without the exception).

Q7 *The discussion in the paper is about concepts and principles — and not at this stage practicalities — and the paper uses a variety of simple examples to illustrate the various approaches and various conceptual discussion points. The examples are set out in Appendix IV. Do you believe there are other examples that would illustrate or highlight issues of concept or principle that are not so far identified in the paper ? If you do, what are those examples and what new aspect of the debate is it that you think they illustrate or highlight ?*

Q8 *What are your views on the relative merits of the approaches discussed in the paper ? Do you believe that one approach is preferable to the others and could—perhaps after some further development work—be applied satisfactorily in all circumstances ?*
(Please explain your reasoning.)

Q9 *At various points in the paper the authors discuss the issue of perspective ; from whose perspective or point of view (ie through whose eyes) should performance be assessed ? The suppliers or the customers ? For example:*

(a) the issue is first mentioned in paragraphs 3.36-3.39, where it is explained that one perspective is not necessarily better than the other, although one may be better suited (or even an inherent feature) of one particular approach, whilst another might be better suited or a feature of another approach ;

(b) the issue is also discussed in paragraphs 4.4(c), 4.5(b) and 5.7(c), where it is explained that critical event approaches generally (but not necessarily always) apply a customer perspective whilst continuous approaches tend to apply a supplier perspective.

In your opinion is this discussion complete and sufficiently conclusive ? If you think it

is not, could you please explain what more you think should be said and why.

Q10 *Do you believe there are particular aspects of the revenue debate that have not been covered in this paper but are worthy of consideration. If you do, what are they and why do you believe they are worth exploring further.*

EFRAG discussion paper does not deal with measurement, and measurement is a key issue to be solved if the presentation of revenue in the income statement is to be useful to users. We regret that EFRAG has not made any proposal aiming at defining what the revenue line in the income statement ought to portray.