

Project Manager
International Accounting Standards Board
30 Cannon Street

London EC4M 6XH
United Kingdom

Weinheim, 18/06/09

Dear Sir or Madam,

PRELIMINARY VIEWS ON REVENUE RECOGNITION IN CONTRACTS WITH CUSTOMERS

We appreciate the opportunity to comment on the boards' preliminary views on "Revenue Recognition in Contracts with Customers".

The Association for the Participation in the Development of Accounting Regulations for Family-owned Entities (VMEBF) was founded in 2006 and consists of German companies with a strong family shareholder background. Beyond its members, the association represents the vast majority of family-owned small and medium-sized entities in Germany, often legally organised in the form of partnerships. The aim of the VMEBF association is to make the role of German family businesses as stakeholders in the development of international accounting more visible and to act as a constructive partner for the standard setters. We work closely together with the German standard setter GASC and the German Institute of Chartered Auditors (IDW) as well as other political institutions.

Already today, numerous non-publicly listed entities in Germany and worldwide are preparing IFRS consolidated financial statements. The IASB's approach to standard setting is supposed to be consistent with the objective of converging external financial reporting and internal management information and therefore is likely to be able to provide users of financial statements with decision-useful data. This is one of the main reasons for many non-publicly listed entities to prepare IFRS consolidated financial statements voluntarily. However, the unforeseeable current developments and the number of unsettled questions on the conceptual level have proven to be the major obstacle to the further application of IFRSs. From our perspective, meaningful regulations on revenue recognition seem to be an inevitable requirement to further

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increase the application of IFRSs internationally. Only a consistent approach to recognising revenue taking into account the business model of the entity and considering the substance-over-form criterion can result in decision-useful information.

We acknowledge the boards' efforts to develop one single comprehensive principle to recognising revenue. However, we doubt that applying the contract-based model will lead to meaningful information under any circumstances or can be consistently applied to all kinds of contracts with customers. This mainly applies to long-term customised construction contracts. In our view, the proposed model does not seem to be systematically coherent with other basic principles to be applied (e. g. performance reporting or the framework). We do not by any means identify the additional benefits of the proposed model outweighing the excessive costs resulting from its application. In this context, disclosure requirements will be a further prominent expense factor not yet discussed by the boards. We therefore oppose the views as outlined by the boards.

Besides, we welcome the boards granting a comment period of about six months for the current discussion paper. Therefore, we would appreciate the boards determining a standardised comment period of six months for all of their future conceptual DPs/EDs due to the vast number of DPs/EDs issued and the excessive consultation processes required as well as the operational work to be done in parallel by most of the constituents.

Please refer to the appendix to this letter for our detailed answers to the questions asked in the discussion paper.

Kind regards,

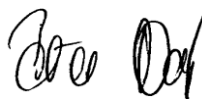
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Appendix:
VMEBF comments on the boards' additional questions

Question 1

Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

We do not agree with the boards' proposals. As already outlined in our cover letter, we acknowledge the boards' efforts to develop one single comprehensive principle to recognising revenue in general. However, we doubt that applying the contract-based model would lead to meaningful information or could be consistently applied to all kinds of contracts with customers, especially when it comes to long-term customised construction contracts.

The assessment of contracts with customers can only lead to decision-useful information, if the "substance" of the transactions is reflected in the structure of the underlying contract. For example, if the partners in a long-term construction project contractually agree on certain milestones and those milestones reasonably reflect the transfer of assets in the project, the contract-based model might lead to a meaningful allocation of revenues over time. However, in practice a lot of long-term customised construction contracts do not contain such milestone arrangements. Especially small and medium-sized entities in the mechanical engineering or building industry often do not have the ability or bargaining power to place partial acceptance clauses or milestone arrangements in their long-term construction contracts. The proposed model would require such entities to apply completed contract accounting for their long-term contracts and therefore lead to only one single transfer of assets, most likely at the expiration of the contract. This, however, would not appropriately represent the pattern of the transfer of assets to the customer over the life of the construction contract.

Furthermore, we believe that accounting for individual/separate performance obligations due to the timing of the transfer of assets would lead to excessive costs and additional workload for the preparers of financial statements.

Firstly, the proposed model is not clear on the level of separating performance obligations. Assume a customised construction contract with a "quality to serve a special purpose"-clause or an arrangement ensuring the adaption of the promised asset to future technological developments. As the timing and even the incurrance of the separate obligation is not known, the separation of such components of the contract would be rather arbitrary.

Secondly, since customised construction contracts are usually uniquely drafted and not comparable to other contracts, the determination of the stand-alone selling prices of the separate goods and services would also be highly arbitrary. Suppose the above-mentioned example of a contractual arrangement to adapt a transferred asset to future technological developments: Separately pricing such a component of a con-

struction contract would lead to extremely subjective outcomes and hence to information that is less reliable and by no means understandable to users.

On a conceptual level, we think that particularly in industries like the mechanical engineering sector, the building industry or the shipbuilding sector the implementation of the proposed model might bring about divergence between external financial reporting and internal management information. Project oriented management is widely spread in those industries, meaning that most long-term construction contracts are internally accounted for and controlled according to their stage of completion. Therefore, completed contract accounting as mostly required by the contract-based model would contradict the boards' objective of further converging management's perspective and external financial reporting.

As mentioned in our cover letter, we acknowledge the idea of reducing the elements of a contract to its assets and liabilities. This is suitable from a legal perspective. However, with the above-said in mind we strongly doubt the possibility of appropriately converting this idea into accounting practice and therefore strongly oppose the boards' proposals. The proposed revenue recognition model would on the one hand lead to less decision-useful information for a variety of contracts (cf. question 2). On the other hand, the model would require preparers of financial statements to review the vast majority of their contracts – especially customised construction contracts – with respect to the specific components of the contracts as well as the legal environment of the underlying jurisdiction. This would lead to an unforeseeable increase in the costs of financial statement preparation as well as auditing, not least because of documentation and disclosure issues yet to be discussed. We do not see the outstanding benefits of the proposed model justifying the excessive costs imposed.

Moreover, the proposed model seems to lack profound in-depth research concerning the coherences of the approach with other issues like performance reporting or the conceptual framework (control; matching principle). To develop a revenue recognition model providing decision-useful data we recommend as a first step to identify precise criteria for distinguishing different types of transactions, e. g. standardised vs. customised transactions or transactions related to services vs. goods. On that basis one would have to design appropriate rules to account for the different types of transactions. Having developed a set of rules, which consider different types of sale transactions, a multiple-element transaction would have to be accounted for by applying a mixture of those regulations. We are aware that this approach would not solve the problem of objectively and reliably separating performance obligations in multiple-element transactions. A feasible solution could be to prohibit the allocation of the transaction price to separate performance obligations if there is no objective and reliable evidence of fair value of the single component (cf. EITF 00-21). This would not only strengthen the decision-usefulness of the information provided but also prevent preparers from the application of costly but still rather arbitrary models separating performance obligations. However, excessive in-depth research would be required to further develop such a new and comprehensive approach to recognising revenue and reliably separating performance obligations in multiple-element transactions.

Considering the evident differences between customised construction contracts and ordinary standard sale transactions and the inability of the contract-based model alone to reflect the economic substance of both transactions (assuming the circumstances discussed above), we would recommend the boards to retain the current revenue recognition standards for goods and construction contracts in the first place. Nevertheless, the boards should address the inconsistencies within the existing IFRSs by revising some of the specific regulations. To be consistent with the principles-based approach, the boards for example could declare the risks and rewards approach to be the benchmark method with the percentage of completion (PoC) method being an allowed alternative treatment for some specified kinds of transactions. Additionally, the existing standards at least have to be amended with regard to additional guidance on services and multiple-element arrangements.

Considering that such a proposal could only serve as a temporary solution as well as the lack of profound in-depth research on the contract-based revenue recognition model, we recommend incurring further time and cost for developing a comprehensive revenue recognition model as suggested above.

Question 2

Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

As already stated under question 1, the proposed model would not provide decision-useful information for many long-term customised construction contracts. Particularly in industries like the mechanical engineering sector, the building industry or the shipbuilding sector certified customer acceptance is an essential condition for the satisfaction of the performance obligation. Therefore, the completed contract method would have to be applied. Especially small entities might suffer from the application of the completed contract method. For example, small shipbuilders often can only execute one order at a time what might lead to accounting insolvency although the project they work on as a whole might be highly profitable. We think that the application of the PoC-method would provide more decision-useful information with respect to long-term customised construction contracts.

Problems applying the contract-based model might also arise when an entity does not keep goods in stock, but instead arranges for third-party suppliers to drop-ship merchandise on its behalf. The DP gives no guidance on how to account for or present such transactions, particularly with regard to the transfer of assets. In fact, under current US-accounting standards related issues have been addressed in EITF 99-19.

Furthermore, the model might lead to biased information when applied to contracts with a right to return the assets transferred. As it appears that under the proposed approach revenues have to be presented gross, a returned asset would lead to repeated revenue recognition on resale.

Question 3

Do you agree with the boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

We basically agree with the boards' definition. However, we are not sure whether e. g. arrangements ensuring the adaption of the promised asset to future technological developments would be contractual obligations under the proposed definition as the DP is not clear on the enforceability of such uncertain obligations.

Question 4

Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

As already stated above, the DP is not clear on contingent or uncertain obligations

(cf. question 3). The proposed model does not provide guidance on how such obligations would have to be accounted for.

Moreover, we believe that the asset definition as applied to services in chapter 3 of the DP needs to be further specified, e. g. when assessed in the context of the boards' preliminary views on customer acceptance or customer intent. Therefore, we would propose the boards to further specify their guidance on services representing performance obligations.

Regarding the boards' definitions, we see tremendous problems separating multiple-element arrangements into stand-alone performance obligations. This is due to the lack of guidance on the level of separation (especially when the timing of the transfer of assets is uncertain) as well as valuation issues in case fair value is not directly observable. Moreover, the definition of performance obligations might conflict with IAS 37, respectively ED IAS 37, e. g. when classifying warranties as performance obligations.

However, as essential issues such as contract renewal/cancellation options, combining contracts and changes in a contract's terms/conditions after contract inception have not yet been discussed by the boards, we are not able to foresee overall applicability of the definition.

Question 5

Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

We do not agree with the boards' proposal. From our point of view, separating the performance obligations on the basis of the timing of asset transfer using the control criterion seems to be rather complex and impracticable (cf. questions 1 and 2).

Question 6

Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

No, an entity's obligation to accept a returned good and refund the consideration should not be a performance obligation. As revenues are presented gross under the proposed model, a returned asset would lead to repeated revenue recognition on resale. Therefore, revenue should only be recognised at the expiration date of the return right or – regarding mass transactions – if there is a reliable estimate for the percentage of goods returned. However, the model conceptually has to be in line with IAS 37 and ED IAS 37 respectively.

Question 7

Do you think that sales incentives (eg discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

From our point of view, sales incentives like customer loyalty programs or free goods/services give rise to separate performance obligations because they constitute the obligation to transfer goods/services at a future date. Nevertheless, the boards should consider materiality issues especially when applying the principle to discounts on future sales. Otherwise, the costs of preparing, auditing and presenting the information would by far exceed the benefits of the information.

Question 8

Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

As already mentioned under question 1, we do not agree with the boards' proposal. Although we see the boards' effort to implement "control" as a common principle (cf. the DPs on the conceptual framework or ED 10), we do not think that "control" is a workable principle in this context. In association with the contract-based model, the interpretation and application of the control principle would be subject to the national jurisdiction and the legal environment of an entity and therefore diminish comparability.

Thus, we believe it is most important to develop a consistent revenue recognition model that is applicable across different legal forms and jurisdictions and complies with the conceptual framework as well. As even the DPs on the conceptual framework are not yet clear on an appropriate control principle, the proposed model seems

to lack profound in-depth research concerning the coherences of the approach with other issues (e. g. performance reporting or the conceptual framework).

Moreover, there are lots of pending questions regarding the practical implementation of the principle. For example, the control principle might not be easily applied in the context of international commercial terms (e. g. EXW/FOB/CFR), retention-of-title clauses or some bill-and-hold arrangements as described in par. 4.6 of the DP.

Question 9

The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

From our point of view, it is crucial to distinctively separate performance obligations as defined in the DP from liabilities as defined in the conceptual framework and IAS 37 as well as ED IAS 37. Please also refer to our answer on questions 1 and 2 above.

Question 10

In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

(a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

We basically agree at the current stage of the project. Nevertheless, we believe that this question should not be answered conclusively without a profound discussion about the measurement of contractual rights and an appropriate consideration of the time value of money measuring the performance obligation.

(b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?

We agree with the use of a cost trigger as it seems to be in line with IAS 37 and ED IAS 37. However, as the DP is not clear on the fact whether a single performance obligation or the whole contract should be subject to the onerous test, we would strongly prefer the test only being applied to contracts as a whole. Otherwise, the information presented would be arbitrary resulting in misleading information and impaired comparability.

(c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.

As already stated under question 10 (a) the applicability of the measurement approach depends on the further discussion of a variety of issues not yet discussed

by the boards. Moreover, as mentioned under question 10 (b), the proposals regarding remeasurement are only workable when to be applied on a contract-level instead of a separate obligation-level.

- (d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.**

As already described above (question 1), we think that the boards especially should retain the current revenue recognition regulations regarding customised construction contracts.

Question 11

The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (eg selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.

- (a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?**

We think that more sophisticated guidance has to be given on contract origination costs. For example, in the mechanical engineering or the construction industry it is common practice to produce elaborate design drawings or construction models in order to obtain a contract. However, as the costs of preparing such drawings or models economically are related to the construction process rather than contract origination this should be reflected in the revenue recognition model, no matter if the costs incurred are recovered or not. In management practice the production of design drawings or construction models most often states a part of the stage of completion. Hence, those costs should be capitalised if they can be directly allocated to the project.

- (b) In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.**

Please refer to our comments on question 11 (a).

Question 12

Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

We do not agree with the boards' proposals. As already explained under question 1, customised construction contracts usually are uniquely drafted and not comparable to other contracts. Therefore, the determination of the stand-alone selling prices of the separate goods and services would be highly arbitrary. Assume the example of a contractual arrangement to adapt a transferred asset to future technological developments: Separately pricing such a component of a construction contract would lead to extremely subjective outcomes. Similar to the regulations set out in EITF 00-21, the boards should prohibit the allocation of the transaction price to separate performance obligations if there is no objective and reliable evidence of fair value of the single component.

Question 13

Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

As already mentioned under question 12, we think that the use of estimates should be constrained, especially if the stand-alone selling prices cannot be estimated reasonably (cf. EITF 00-21). However, approximating stand-alone selling prices for a variety of different contracts within an entity might lead to the requirement to disclose a huge amount of additional information in the notes. Thus, the boards should carefully discuss the costs and benefits of the proposed principle.