19th June 2009

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

Dear Boards' members,

Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF) the accounting standards setter body in Mexico, welcomes the opportunity to submit its comments on the *Discussion Paper: Preliminary Views on Revenue Recognition in Contracts with Customers*. Set forth below you will find our comments to the topics included in the Discussion Paper.

# Chapter 2

#### 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 agree with the view that a single revenue recognition principle for a contract asset or a contract liability of the entity is desirable and that the net position in the contract is an adequate unit of account for recognition and measurement purposes. However, the approach established within the scope of the Discussion Paper (DP) is not comprehensive. In the foundations of the model proposed the periodicity of the revenue recognition depends on the satisfaction of performance obligations, which depends on the assets transferred to clients based on control; this last point must consider that control is given away along with the transfer of risks and rewards, moreover in accordance with the completion percentage method regarding long term construction contracts or in a similar way in insurance contracts. This will contribute to clearly express in the DP that an asset is transferred in stand-ready obligations or in continuous transfer situations.

## 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?

The DP highlights four types of contracts which are outside of the scope of the proposed model, such types of contracts are: financial instruments established in the IAS 39; insurance contracts established in IFRS 4; leases established in IAS 17; and agriculture established in IAS 41 (paragraphs S11 and S12). However, some of these contracts have similar characteristics to the ones within the scope proposed by the DP. Especially, the

right of use in software contracts is similar to the related leasing contracts (standard on study); additionally, the stand-ready obligations such as the guaranty contracts are similar to the insurance contracts (standard on study). We urge you reconsider these topics very carefully and, in case the various development models turn out different from the new proposed model in the DP, it is important to consider which is the most proper and consistent.

The application of the proposal for long term contracts does not reflect the economic substance of the performance obligation and the changes in value derived from it. The principle must reflect the economic activity pattern of the contract that represents useful information for users' decision making. We do not believe that these types of contracts should be considered separately, because by doing so the opportunity of achieving a greater coherence in the recognition of different types of contracts will be missed; thus, if possible it must be evaluated.

We consider a clear guide is necessary to assist preparers identifying the criteria to consider which type of contracts could or should recognise revenues based on the advance of their activities (it is necessary to review when control and risks and rewards must be reviewed). For example, when in a contract the supplier has the right to receive a monetary consideration equivalent to the work performed to date.

We believe that detailed application of the proposed principle would increase the usefulness of information in the financial statements used to make economic decisions related to long term contracts which do not contemplate a continuous control transfer according to the DP terms. Otherwise, an entity could not recognise reported revenue until the final delivery of the good or service, eventually resulting in volatility on the revenues and their corresponding income margin.

We recommend that assessments of the new model's impact be performed together with proper and sufficient field tests in order to ensure that the new model may be generally applied. Also, we recommend to provide enough application and implementation guidance to help in the understanding and application of this proposal.

# **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.

The proposed contract definition seems reasonable. However, such definition should be applicable to all standards in order to avoid ambiguity from the use of a different wording; in addition, the definition in paragraphs 2.12-2.13 of the DP should be consistent with the one included in IAS 32.

Sometimes, certain professional services could have an important work advance before achieving the signature of the contract. Therefore, we believe it is convenient to establish application guidance to promote consistency in determining the factors to identify the moment in which a contract is sufficiently defined for the recognition of revenues, for example, those factors established on SAB 104 from the SEC.

# Chapter 3

#### **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.

We agree with the definition proposed for a performance obligation because it represents a more coherent and improved reference in order to help entities when determining their existing compromises and the moment of revenue generation. However, it is necessary to establish practical application guidance to support the important judgment load, based on facts and circumstances of the contract, which may be implicit in the application of this model to all transactions, as it is stated in the DP in its paragraph 6.31. For example, in a construction contract the compliance with an obligation can be interpreted as occurring in the different advances of the project based on the contract as a whole or in accordance to its parts. In such circumstances, the allocation of the contract price to the related performance obligations could generate interpretation problems and affect comparability.

Notwithstanding, we agree that the control transfer because is more consistent for decision making, especially to identify the moment in which the assets must be transferred and, thus, the definition of a performance obligation is satisfied; there are very complex cases, where determining when the control of an asset is transferred may demand excessive legal determinations. Therefore, we believe that in the definition of control is convenient the concepts of risks and rewards are analysed, as it was done, for example in IFRIC 15, Agreements for the Construction of Real State, where reference was made to paragraph 14 (a) of IAS 18, Revenue that establishes: "the entity has transferred to the buyer the significant risks and rewards of ownership of the goods", which was determinant for the recognition of revenue in this type of contracts.

## **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?

Yes, we agree that an entity should recognise separately the performance obligation on the basis of occurrence of control transfer through the promised deliveries to the client. However, in some cases it is difficult to identify when the obligation is satisfied in the absence of a tangible asset or of a physical service activity that can be identified as the transferred asset or, sometimes, the performance obligation can be made or completed without producing a legal document from the other party. For example, this appears with a higher incidence in the long term construction contracts, where the completion phases recognised as completed are carried on according to the contract and this satisfies the risks and rewards transfer as it occurs, even though the transfer of ownership of the good is not done yet.

#### 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?

We agree that return right clauses of goods in a contract represent a performance obligation and that this right is an asset transferred to the client, resulting in revenues recognition allocated to that contract component at the time of the initial sale. Nonetheless, although the identification of an additional payment in order to obtain a return right as an additional service is a useful indicator (paragraph 3.37 in the DP), we believe that in many cases it is not a determinant criterion because it is not expected a return of the goods during the normal operating activities of the entity. Consequently, in these cases, it has to be recognised when the return occurs, because the return right promised is a contract term that has to be complied eventually. Furthermore, the allocation to a contract component is not clear in the absence of a tangible asset or a physical service activity. Also, we do not agree with the failed sale model.

## **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?

This topic is partially consistent with IFRIC 13, *Customer Loyalty Programmes*; however, we consider that discounts on a future sale generate a performance obligation that the entity must fulfill if the client exercises its right, our concern is reliability on the determination of the obligation.

Paragraph 3.33 in the DP states that revenues are recognised only when the incentive is redeemed or amortised; however, we consider that guidance as to how to face maturities and changes in the expectative of maturities is necessary. Also, application guides are required to clarify the treatment for volume discounts and cash withdrawal incentives.

## Chapter 4

### **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.

We agree with this approach which is aligned with the Conceptual Framework asset definition. The transfer of resources to another entity indicates the termination of a performance obligation and the recognition of revenues; however, the control concept may present difficulties in its interpretation and application, because the control concept is used in different contexts within IFRSs and depends on facts and circumstances of each case. Nowadays, this term has a variety of meanings in different parts of IFRSs. For example, in IAS 18 control is not defined, but might be associated with the participation in

management, in IAS 27 the concept of control is based on the power for making decisions and in IAS 39 on the practical ability to sell an asset. Hence, it is not clear in the DP how the control concept will be applied on long term construction contracts. Thus, it is important to carefully define the control concept.

In all the examples of TOOLCO in the DP, the point of view presented in paragraphs 4.11 and 4.18-19, where there are different rights legally enforceable based on control, could implicate an economical effect that must be recognised in different ways; in addition, some contracts may be recognised in different ways if the wording of the text is not accurate. For example, a client may have the right to change the supplier at a certain date, but often it is not attractive or in some cases it is onerous, particularly if there exists a penalty for cancellation. The indicator of the payment conditions for consulting services in paragraph 4.37 is insufficient. On this respect, we believe it is necessary to have clear application guidance for a wider range of services.

### 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.

The relationship of periodicity in a performance obligation is a suitable approach for revenue recognition in most of the contracts. We believe that it is probable that a substantial reduction in the level of useful information for decision making under this model occurs for long term contracts where there is a continuing transference.

The proposed approach does not provide useful information for decision making on long term construction contracts and on service agreements, because the performance obligation is satisfied as the control of the asset is transferred to the buyer, which could occur until the termination of this contract. In these cases, the economic substance of a continuous sale is not perceived as the risks and rewards are transferred during the contract execution. Therefore, we consider that relevance as part of useful information is affected for decision making in those contracts.

## Chapter 5

#### 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?

Yes, we believe that the initial measurement must be based on transaction prices through execution of activities for performance obligations under contract terms; however, the DP does not consider variable contracts or contract with contingent fees, even if they suggest that initial measurement should be based on a better estimate of the expected value.

(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?

Yes, remeasure an onerous contract to the entity's expected cost satisfies the performance obligation of the entity and constitutes an easy basis that can provide useful information for decision making in most of the cases, which encourages a more consistent application.

(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.

Yes, we support the development of a single simplified model applicable to most of the contracts; however, the proposed approach could create volatility in the recognised margins when satisfying a performance obligation if there is variability in the possible outflows. We believe that additional disclosures are required in order to help users of financial statements to identify those contracts for which volatility is important, such as long term construction contracts and some types of guaranty obligations.

(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.

We have not identified performance obligations that require a different measurement approach, we agree with the initial measurement proposals; nevertheless, our concerns are related to subsequent measurement, particularly with the satisfaction of a performance obligation in the different phases of advance in long term contracts, such as construction contracts. We believe that a more general principle should be enough to handle a diversity of contracts, without exceptions.

## **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?

Yes, we agree. These costs are part of the total amount of the contract that the entity will try to recover and they must be recognised as an asset, if they satisfy all the assets recognition criteria.

(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.

These costs must be recognised as an expense when they do not fulfill the assets recognition criteria. However, different types of industry should be analysed and considered since this requirement could be controversial. We suggest providing implementation or application guidance for identifying when and how an asset could be recognised. In some cases, we believe that the conditions for an asset recognition according to IAS 38 *Intangible assets*, can be fulfilled. Another example are contracts where a long tender process is required, similar to the one identified in IFRS 3, *Business Combinations*.

### 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?

In principle, we agree; however, we believe that new guidance or some accuracy is required. Paragraphs 5.45 and 5.46 of the DP indicate that the proposed model requires the transaction price allocation for every performance obligation proportionally to the individual/stand-alone sale price of the underlying promise of good or service; and establishes that, when a individual/stand-alone sale price is not observable, the entity might estimate it.

We agree that the individual/stand-alone sale prices measurement in order to allocate them represents a logical approach when determining a performance obligation; however, our concern is that it could be very difficult measuring them reliably in all circumstances where they are not observable. The model proposed does not offer an alternative approach for these situations.

In fact, when the individual/stand-alone sale prices cannot be estimated reliably, it is convenient to consider permitting other adequate basis to provide entities with a verifiable support for transaction price allocation to each performance obligation.

## **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?

Yes, we agree. In practice, the estimates can be determined using internal information or prices from suppliers. Even if the entity does not sell the different elements separately, a reasonable margin can be assigned. This is evident regarding long term construction contracts.

Should you require additional information on our comments listed above, please contact me at 00-52-55-5596 5633/26/34 or by e-mail at fperezcervantes@cinif.org.mx

Sincerely,

C.P.C. Felipe Perez Cervantes President of the Mexican Accounting Standards Board Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF)