

International Association of Consultants, Valuators and Analysts

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

Ladies and Gentlemen,

This letter of comment is submitted on behalf of the IFRS Committee of the International Association of Consultants, Valuators and Analysts (IACVA), a member of the International Valuation Standards Council (IVSC) and the World Association of Valuation Organizations (WAVO). We are a knowledge transfer and credentialing organization with Charters, issued or pending, in China, Germany, Ghana, India, Indonesia, Mexico, Middle East, Nigeria, Philippines, Russia, South Korea, Taiwan, Thailand, the United States (National Association of Certified Valuation Analysts – NACVA and the Institute of Business Appraisers – IBA) and Vietnam. The organization has nearly 10,000 members, who are mainly involved in business valuation and fraud deterrence.

As a worldwide organization, our members are extremely concerned with the development of the valuation provision in International Financial Reporting Standards (IFRS), as well as Generally Accepted Accounting Principles in the United States (GAAP). They are especially worried by the trend in the convergence activities that seems to result in IFRS moving towards GAAP rather than the process correcting the many practical deficiencies and complexities of the recent codification, especially its excessive rules.

We appreciate the opportunity to comment on the Exposure Draft "Revenue from Contracts with Customers".

Our detailed observations to the questions in this ED are as follows:

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 that 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 agree with the principle but would prefer accounting for contract modifications as separate contracts unless the prices were completely interdependent. In our view, the facts of Example 2 in paragraph B3 do not reflect interdependent prices but, in reality, a new contract at a lower rate reflecting current conditions.

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 good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligation s and why?

We agree with the principle set out in paragraph 23 except for clause (iii) as, in our view, a standard profit margin does not prevent products or services being distinct.

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?

We agree that the proposed guidance in paragraphs 25 to 31 and the related application guidance in B4 to B38 are very helpful in detailing when control of promised goods or services have been transferred, except for construction contracts (B43). In most such situations, the customer does not obtain actual control of the project until completion, even though progress payments take place as milestones are reached. We would support treating the partially completed project as inventory, less the progress payments resulting in either a net asset or liability. Reversals should be recognized and costs transferred based on the activity in the various stages. Those, such as: foundations, structure, mechanical, electrical, etc. being treated as separate contracts.

Question 4: The boards propose that if the amount of consideration is variable, an entity should recognise 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 recognise 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 recognising revenue when the transaction price is variable and why?

We agree that revenue should be established on the basis of estimated transaction setting prices, however, we find conditions (a) and (b) of paragraph 38 unduly restrictive. In many cases a transaction price can reasonably established by engineering studies.

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 recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?

Every transaction involves some credit risk which is reflected in the price. On an entity basis, the historic loss performance is reflected in the target margins. We therefore recommend that the recognition of revenue and the possible credit losses be decoupled. The business's credit rating should not affect the revenue to be recognized, but merely the profit that is recorded.

Question 6: Paragraphs 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 the value of the financing component (if any) should be treated as an additional performance obligation covered by the contract.

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 concur that the transaction price be allotted to the various performance obligations based on their relative (estimated) stand-alone selling prices.

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 38 Intangible Assets or ASC Topic 985 on software), an entity should recognise 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 recommend that the definition of inventory in IAS 2 *Inventory* be modified to allow the recording of deferred client contract costs as an asset if they are not established as such under another IFRS.

Question 9: Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation. Do you agree with the costs specified? If not, what costs would you include or exclude and why?

We would suggest that the costs listed in paragraph 58 be expanded to cover:

- (f) direct selling costs such as agents' commissions and proposal preparation
- (g) reasonable overhead related to the costs allowed for existing items (a) and (c), existing item (d) will normally reflect such overhead.

Question 10: The objective of the boards' 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?

The boards must be careful that their required disclosures do not result in the publication of confidential commercial information that might be considered "trade secrets". The required segment disclosures is, in our view, the best arena for such information, as the nature of the amounts, timing and un-collectability of revenues from contracts with customers will tend to vary with the nature of the activity. In particular, we feel an undue burden is placed on management by having to disclose information about the amounts, timing and uncertainties of the cash flows arising from such contracts as this involves complex projections of costs.

We therefore suggest that paragraph 69 be limited to revenues and have a de-minimus criteria with only contracts representing say, 5% or more having to be disclosed at the segment level.

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?

We suggest that amounts related to contracts with a term of more than one year only have to be disclosed in aggregate.

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?

We do not agree with the categories listed above. We prefer the simple groupings of Products, Re-sales and Services at both the Revenue and Costs of Sales levels.

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.

We see no benefit of requiring an entity to apply the proposed IFRS retrospectively. Investors are always looking forward. A comparison, in the Notes, of the current year's revenues and related direct costs under proposed regime and that previously adopted should be sufficient.

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?

We believe that the application guidance set out in Appendix B is an essential part of the IFRS. We suggest it be expanded to give more illustrative examples and greater disclosure of how the necessary judgement is to be applied with explanations of all the thought processes used.

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 specified in the contract. 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 strongly disagree with the Board's view of product warrants. In our opinion, they are a potential future "make good" cost that should be accrued rather than a performance obligation.

Question 16: The boards propose the following if a licence is not considered to be a sale of intellectual property: (a) if an entity grants a customer an exclusive licence 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 licence; and (b) if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer the licence and it satisfies that obligation when the customer is able to use and benefit from the licence. Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

We believe that the nature of the sale of a license is similar to that of a partial interest in the relevant Intellectual Property Rights and should therefore be accounted for on that basis. The performance obligations should be separated only to the extent that a contract (most do) involves future payments for support and other services. The degree of exclusivity is not normally relevant as in either case, there may or may not be sublicensing rights.

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?

We suggest that the proposed revenue model be adopted for all sales of assets.

Question 18 [FASB only]: Should any of the proposed requirements be different for non-public entities (private companies and not-for-profit organisations)? If so, which requirement(s) and why?

This question if not applicable.

for P. Cots

Should you wish to discuss this matter further, a member of your staff may contact the writer in Toronto, at 416-865-9766.

Respectfully submitted on behalf or the IFRS Committee of IACVA Per

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Chair