

By email: director@fasb.org

Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116 USA

3 November 2010

Re: ED/ 2010/6 - Revenue from Contracts with Customers

Dear Technical Director,

We are writing on behalf of the International Corporate Governance Network (ICGN). The ICGN is a global membership organisation of institutional and private investors, corporations and advisors from 50 countries. Our investor members are responsible for global assets of US \$9.5 trillion.

The ICGN's mission is to raise standards of corporate governance worldwide. In doing so, the ICGN encourages cross-border dialogue at conferences and influences corporate governance public policy through ICGN Committees. We promote best practice guidance, encourage leadership development and keep our members informed on emerging issues in corporate governance through publications and the ICGN website. Information about the ICGN, its members, and its activities is available on our website: www.icgn.org.

The purpose of the Accounting and Auditing Practices Committee (A&A Practices Committee) is to address and comment on accounting and auditing practices from an international investor and shareowner perspective. The Committee through collective comment and engagement strives to ensure the quality and integrity of financial reporting around the world.

http://www.icgn.org/policy_committees/accounting-and-auditing-practices-committee/

We are pleased to respond to your request for comment on the Exposure Draft 2010/6 – Revenue from Contracts with Customers (ED/2010/6).

We support the IASB and FASB working towards convergence of the concepts of revenue recognition. There are a number of underlying conceptual issues with revenue recognition that have to be carefully considered in order to maintain comparability of financial reporting for users. On the one hand, we believe the performance obligation approach in the ED is a robust criterion for revenue recognition. On the other hand we feel that the concept of control deserves further clarification for more complex business relationships and that the probability-weighting of revenues makes the measurements too subjective and is an additional layer of opaqueness.

Please find our detailed comments on the ED/2010/6 as follows.

- 1. Paragraphs 12-19 propose a principle (price interdependence) to help an entity determine whether:
 - to combine two or more contracts and account for them as a single contract:
 - to segment a single contract and account for it as two or more contracts; and
 - 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?

Whilst the ICGN agrees with the principle of interdependence in the ED, there needs to be clearer guidance as to when to account for a contract modification. Pricing can be modified for a number of reasons, and we do not believe a single principle can capture all of these in that it is important that accounting for revenue recognition reflects the underlying economics of the contract with a customer.

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. 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?

ICGN generally agrees with the proposed guidance for separating performance obligations and the principle in paragraph 23 for determining when a good or service is distinct. However, the condition in (23(b) ii), the existence of a distinct profit margin, lacks clarity.

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?

In our previous submission to the Boards on this issue in 2009, we objected to the use of control as the main criterion for revenue recognition. In our opinion the transfer of risks and rewards is necessary as well. Unless risks and rewards are transferred to the customer there should be a presumption that control to some extent has been retained. However, risks are not mentioned explicitly here, and preparers of the accounts are given room for subjectivity in the interpretation of the guidance, affecting comparability. ICGN suggests that the following sentence should be added to the second sentence of paragraph 27: "and carry substantially all the risks associated with these benefits".

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 ICGN agrees that the fact that transaction prices are estimated should not preclude recognition of revenue. The conditions in paragraph 38 are necessary, but not sufficient for a reasonable estimate. The ICGN sees the need for more guidance in this area. In fact we believe that the concept of "a reasonable estimate" itself is in need of clarification. Traditionally "reliable estimates" has been the preferred term.

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?

ICGN believes that the use of probability-weighting as proposed in paragraph 43 for determining the expected revenue on satisfaction of a performance obligation is too subjective. We therefore believe that there should be a recognition threshold if credit risk is abnormally high or volatile. Nor do we agree with a customer's credit risk being reflected in revenue in that credit provisions should be reported on a separate line in the income statement in operating expenses as otherwise this reduces the comparability of revenues.

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?

ICGN agrees that an adjustment for the time value of money is appropriate in when payment is deferred as well as advanced if amounts are material.

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?

ICGN agrees that the transaction price at inception should be allocated to all separate performance obligations in proportion to the stand-alone selling prices of the good or service underlying each of the performance obligations.

8. Paragraphs 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 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?

ICGN supports the proposals in paragraph 57 in that they will allow an asset to be recognized where it is clear that future economic benefits will be generated but are restrictive enough to prevent over-capitalisation.

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?

ICGN agrees with the ED that both direct and allocated costs relating to future performance of that specific contract should be recognized as an asset. We also agree that costs that are not related to future performance should be expensed as incurred.

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?

ICGN agrees that disclosures should meet user needs. This principles based approach to disclosure is appreciated. For the objective of the ED to be successful it must be understood that corporations must be sensitive to user needs and listen to user requests. This should be explicitly stated in the standard or the basis for conclusions. The ICGN also emphasizes that users require comparable disclosure to understand amount, timing and uncertainty of revenue and cash flows and that harmonization of disclosures in IFRS with US GAAP is important.

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?

ICGN agrees with the proposal. However, the requirement should be extended to include those contracts with an original timing of less than one year but whose timing has now been extended. The disclosures could be lengthy, and it should be clarified that this information can be given on an aggregated basis and reconcile with the consolidated statement of income

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?

ICGN agrees. An entity should be able to classify its contracts both by service type, maturity and geographically in a similar way to segmental information. It would be useful for investors to see more than one cut of the business engaged in by the entity if it operates in different geographies and lines of business. The classification, albeit aggregated into portfolios with different characteristics, should reconcile with the consolidated statement of income.

13. Do you agree that an entity should apply the proposed requirements retrospectively (i.e. 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 alternate 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.

ICGN believes that an entity should apply the proposed requirements retrospectively for all contracts in existence during any reporting periods presented because this allows for greater comparability both within entities and across entities. This should also apply to a classification of contracts as discussed under item 12.

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?

ICGN has noted the volume of application guidance and agrees that there needs to be industry guidance in the interests of convergence with US GAAP. In addition, application guidance should not be the only means of clarifying principles-based standards in that the IASB should seek to clarify the principles in the standard itself.

- 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?

ICGN believes the distinction between warranties in B13 to B19 is unclear and distinguishing defects into latent and post-sale and associating a different type of warranty for each is likely to prove too subjective in practice. Entities are familiar with the calculation of likely warranty liabilities based on historical information and current practice, which is well understood, should be allowed to continue.

- 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?

ICGN does not agree that the pattern of revenue recognition from the sale of a licence should depend upon whether it has been granted exclusively. This is an arbitrary and unconvincing distinction. Moreover, much of the underlying commercial substance is similar to the right to use concept in a leasing agreement. It should be clear from the rights granted as to whether these types of agreement fall within the definition of leasing contracts in which case they would be covered by a future leasing financial reporting standard.

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?

ICGN agrees with the proposal.

If you would like to discuss any of these points, please do not hesitate to contact Carl Rosén, our Executive Director, at +44 207 612 7098 or carl.rosen@icgn.org.

Thank you for your attention and we look forward to your response on the points above.

Yours sincerely,

Christy Wood Chairman, ICGN Board of Governors Elizabeth Murrall Co-Chair, ICGN Accounting and Auditing Practices Committee

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Cc: Sir David Tweedie, Chairman of the International Accounting Standards Board (IASB)