
THE CARLYLE GROUP

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March 13, 2012

Ms. Susan M. Cospers
Technical Director
File Reference No. 2011-230
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update – Revenue Recognition (Topic 605): Revenue from Contracts with Customers

Dear Ms. Cospers:

On behalf of The Carlyle Group (referred to herein as “Carlyle” or “we”), we appreciate the opportunity to comment on the Financial Accounting Standards Board’s Proposed Accounting Standards Update, *Revenue Recognition (Topic 605): Revenue from Contracts with Customers* (“the Proposed ASU”).

Carlyle is a global alternative asset manager with more than \$147 billion in assets under management across 89 funds and 52 fund of funds vehicles, serving over 1,400 investors. Our funds invest across a range of investment strategies, including corporate buyout, growth capital, real estate, infrastructure, energy and renewable resources, distressed debt, corporate mezzanine, energy mezzanine, hedge funds, and structured credit. Our fund of funds vehicles make investments into buyout, growth capital, venture and other alternative asset funds advised by other general partners, make co-investments alongside other private equity and mezzanine funds, and acquire interests in portfolio funds in secondary market transactions.

We support the Board’s efforts to develop a common, high quality standard on revenue recognition and to promote financial reporting that provides information that is useful and relevant to financial statement users. However, we have concerns that the proposed changes would not promote useful and relevant financial reporting to the users of financial statements of certain asset managers, including private equity firms such as Carlyle.

A substantial majority of our revenue and earnings results from performance fees, including carried interest. Based on the provisions in the Proposed ASU that the cumulative amount of revenue that an entity recognizes would not exceed the amount to which it is reasonably assured to be entitled, we are concerned that revenue recognition for carried interest would be deferred until there is no risk the amount could be returned to the fund. This would result in the deferral of revenue recognition until long after the related cash has been received from the fund and distributed to employees and equity owners. We are concerned that the Proposed

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ASU will render our GAAP financial statements even less relevant to our user community and, as a result, will require us to place greater emphasis on non-GAAP financial measures to provide a meaningful presentation of our firm's financial results.

Performance and Incentive Fees Background

Performance fees consist principally of the special residual allocation of profits to which we are entitled, commonly referred to as carried interest, from certain of our investment funds, which we refer to as "carry funds." We are generally entitled to a 20% allocation of the net realized income or gain as a carried interest after returning the invested capital, the allocation of preferred returns of generally 8% to 9% and the return of certain fund costs. We recognize carried interest revenue, which is a component of our performance fee revenue, upon appreciation of the valuation of our funds' investments above certain return hurdles set forth in each respective partnership agreement at each period end as if the funds were liquidated at such date and the investments liquidated at their estimated fair value at such date. Accordingly, the amount of carried interest recognized as performance fee revenue reflects our share of the fair value gains and losses of the associated funds' underlying investments measured at their then-current fair values.

Our revenue recognition is based upon method 2, as prescribed under EITF Topic D-96, "Accounting for Management Fees Based on a Formula." This approach is similar to accounting for investment income and losses; they can increase or decrease in any given period. This methodology is also consistent with how each period's earnings are allocated by the carry funds to the external limited partners and the general partner (Carlyle). The carry funds allocate their earnings at each reporting period assuming a hypothetical liquidation of the fund's investments at their estimated fair value; any carried interest earned based on the hypothetical liquidation is allocated by the carry fund to the general partner as a component of the general partner's earnings for the period. Our methodology is also consistent with how a carry fund's performance metrics are calculated. The net IRR of a fund reflects its investment performance net of the accrued carried interest earned by the general partner as if the fund investments were liquidated at their then-current fair value.

The portion of performance fees that are realized and unrealized in each period are reported separately in our statement of operations. Carried interest is realized and distributed to us from our funds when (i) an underlying investment is profitably disposed of, (ii) the investment fund's cumulative returns are in excess of the preferred return and (iii) we have decided to collect carry rather than return additional capital to our limited partner investors. Realized carried interest may be returned to the fund (a "giveback") if the fund's investment values subsequently decline below certain return hurdles. For any given period carried interest income could thus be negative; however, cumulative performance fees and allocations can never be negative over the life of a fund. If upon a hypothetical liquidation of a fund's investments at the then-current fair values, previously recognized and distributed carried

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interest would be required to be returned, a liability is established for the potential giveback liability. Generally, the actual giveback liability, if any, does not become due until the end of a fund's life. A fund is typically a limited-term entity with a contractual term up to 10 years or more, although the actual termination of a fund will depend on the pace of acquiring and selling its investments.

Performance fees may also include incentive fees or allocations from our hedge funds when the return on assets under management ("AUM") exceeds previous calendar-year ending or date-of-investment high-water marks. Our hedge funds generally pay annual incentive fees or allocations equal to 20% of the fund's profits for the year, subject to a high-water mark. Incentive fees earned in one year are not subject to return to the fund if subsequent investment performance declines (i.e., there are no giveback obligations for the hedge funds). We recognize the incentive fees from our hedge funds as they are earned.

For some asset management firms where performance fees are substantially comprised of annual incentive fees not subject to a potential giveback, the Proposed ASU will not have a significant impact. However, the Proposed ASU will have a significant impact on asset management firms with a substantial component of carried interest revenue that is based upon underlying funds whose lives extend over several years, including private equity funds, with lives of ten years or longer.

A significant portion of our earnings are derived from performance fees from carried interest. As a result, analysts and other users of our financial statements focus on our net earnings from performance fees (performance fees net of related compensation expense). A portion of our performance fees is paid to our investment professionals responsible for managing the respective fund and its investments ("performance related compensation expense"). We recognize performance related compensation expense in the same manner that we recognize the related revenue (i.e., as we recognize carried interest revenue using a hypothetical liquidation of the fund's investments at fair value, we also recognize the compensation expense on that revenue). The balance of the performance fees are generally distributed to our owners net of any reserves for potential giveback obligations.

Analysts and other users seek to understand our realized net performance fees (realized performance fee revenue less related compensation expense) and our net performance fees (realized + unrealized performance fee revenue less related compensation). As such, we and our industry routinely report Economic Net Income, a non-GAAP measure reflecting realized and unrealized performance fees and related compensation, and Distributable Earnings, a non-GAAP measure including only the realized net performance fees.

Existing GAAP enables the reporting of Economic Net Income and Distributable Earnings without revenue recognition adjustments (other than those adjustments required as a result of revenue eliminated upon consolidation of funds). Economic Net Income and Distributable

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Earnings are the benchmark metrics used to value and evaluate firms in our industry. Existing GAAP revenue recognition standards readily facilitate and provide a foundation for these non-GAAP measures. However, we believe that provisions of the Proposed ASU may result in the inability to recognize carried interest revenue in a manner consistent with existing practices (as further described below under Recommendations). As a result, the differences between GAAP under the Proposed ASU and the non-GAAP measures of Economic Net Income and Distributable Earnings will be very significant, to the point of being two completely different bases of accounting for revenue. Decoupling GAAP revenue from non-GAAP measures in such a manner risks not only rendering the GAAP reporting less relevant but also devalues the processes, controls and related reporting on controls governing the GAAP financial statements because our financial statement users would be more focused on the non-GAAP measures.

Recommendations

Under the Proposed ASU, if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognizes to date would not exceed the amount to which it is reasonably assured to be entitled. We believe that this requirement would result in a significant change in practice for revenue recognition from the existing framework of method 2 of EITF Topic D-96. The threshold for revenue recognition in the Proposed ASU would likely result in deferral of any recognition of carried interest revenue until near the end of the term of the fund entity.

As a result, on unrealized carried interest, as a fund's investments appreciate based on Carlyle's investment management performance to the level which would result in carried interest being accrued, no such revenue would be reflected as it would not meet the reasonably assured criteria. Further, as carried interest is realized from a fund and the cash proceeds distributed to employees or owners of the firm, again no revenue would be recognized on the financial statements, as the potential for future giveback results in the revenue not being reasonably assured. Effectively, the Proposed ASU results in years of Carlyle's investment management performance not reflecting any performance fee revenue, until the point in time in a fund's term (near the end) when such carried interest is no longer subject to potential giveback.

Given the significant impact the Proposed ASU will have on performance-based revenue for our industry and the disconnect that it will create between our U.S. GAAP-basis financial statements and what we will present in our non-GAAP financial measures, as part of the Board's deliberation process, we would request that the Board seek the input of industry analysts that specifically cover the alternative asset manager business sector for their views regarding the Proposed ASU. Alternatively, we would recommend that the Board review analyst reports covering this business sector for insights into the key financial metrics that they use to evaluate our peers.

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We also noted that the Proposed ASU does not address a potential disconnect with the timing of recognition of performance-based compensation expenses and other related costs and expenses. Companies that follow method 2 for recognizing performance-based revenue are generally recognizing any related performance-based compensation expense in the same manner, accruing the compensation expense on an unrealized basis in tandem with the related unrealized performance fee revenue. A key financial metric for our financial statement users is measuring our performance-related compensation expense as a percentage of the related performance-based revenue.

Absent any clarifying guidance in the Proposed ASU, we would assume that either (i) the performance-based compensation expenses would continue to be accrued on an unrealized basis as the employees are providing the requisite services, or (ii) the compensation expenses would not be accrued on an unrealized basis but would be recorded as an expense once the cash payment has been made to them from realized carried interest proceeds. In either scenario, the compensation expenses would be recorded in advance of when the related revenue would be recorded under the Proposed ASU. As a result, the aforementioned key performance ratio of performance-based compensation expense to related revenue will no longer be meaningful. While we acknowledge that the concept of matching revenue and expenses is not an accounting principle under GAAP, it nevertheless helps render financial statements more useful to readers. Accordingly, we recommend that the Board review related cost and expense issues that are likely to be a byproduct of the Proposed ASU.

As previously discussed, the accrual of carried interest earnings is consistent with the underlying income allocations of the underlying fund partnership agreements. As such, we request that the Board consider allowing carried interest to be recognized by applying the equity method of accounting, whereby an asset manager would recognize income based upon the allocation of income to the general partner at the respective funds. The result of such an approach will approximate method 2 under EITF D-96.

Conclusion

We are concerned that the Proposed ASU will decrease the usefulness of financial statements and create GAAP-basis financial statements that will not be meaningful to financial statement users if adopted in its current form. Market participants expect that as our management of our funds create value, such value will be reflected in our earnings, not deferred until years later. By using existing GAAP, we are able to demonstrate the results of our asset management activities (positively or negatively) each year as our performance fee revenue increases or decreases accordingly. The Proposed ASU will de-couple our revenue recognition from the performance of our funds. This will result in financial statements users having to place complete reliance on non-GAAP financial measures to evaluate our business and obviating the value of the GAAP-basis financial statements.

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We appreciate the opportunity to offer our feedback on the Proposed ASU. We would be pleased to discuss our views with you at your convenience.

Sincerely yours,

A handwritten signature in cursive script that reads "Curtis L. Buser". The signature is written in black ink and is positioned above the printed name.

Curtis L. Buser
Managing Director & Chief Accounting Officer