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Capital Bank and Trust

## **VIA ELECTRONIC DELIVERY**

March 13, 2012

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

Re: File Reference No. 2011-230

Dear Ms. Cosper:

Capital Group Companies, Inc. (referred to herein as "Capital" or "we") is one of the oldest and largest global investment management firms in the nation. We appreciate the opportunity to provide comments on the Proposed Accounting Standards Update (Revised), *Revenue Recognition (Topic 605): Revenue from Contracts with Customers* ("the proposed ASU"). These comments are informed by our experiences as preparers of audited financial statements of Capital and its affiliated companies. These comments reflect the signer's own views and not necessarily those of Capital or other Capital associates.

## **Scope**

For private equity asset managers, performance-based fees in the form of carried interest are based on fund performance, which are based on varied results and fluctuations of the fund over time. We would like to focus our responses to the reasonably assured estimation criteria and the resulting mismatch of compensation expense, which is connected to the performance-based fees earned in private equity investment management arrangements, resulting from the proposed ASU.

## Reasonably assured

We encourage the Financial Accounting Standards Board ("Board") to revisit the "reasonably assured" estimate and standard for recognizing revenue and allow reporting entities to continue to record revenue based on the liquidation value of the portfolio on the reporting date.

Under current guidance, the private equity asset manager is permitted to recognize revenue related to performance-based fees, over a specified period of time based on the contract and allowed revenue recognition due upon an assumed contract termination. The amount due is based on the funds performance, which is carried at fair value, in accordance with the AICPA Accounting and Auditing Guides, Investment Companies. Any adjustments to the underlying assets are currently reflected in the performance-based fee recognized during a particular period. We believe that the deferral of this revenue until the end of the fund's life does not provide meaningful information to users of the financial statements.

The proposed ASU will create greater volatility in income recognition than the current standard. Private equity asset managers are generally entitled to the performance-based fee if the contract is terminated. By requiring a deferral in recognizing the performance-based revenue will cause a significant variability in reported revenue between periods that is not representative of the true performance of the entity. The proposed ASU removes the reporting entity's ability to record even the most conservative estimated recognition of this performance-based fee. We currently disclose in our financial statements the potential for a contingent liability associated with the obligation to return such performance-based fee depending on future performance. To that point, the carried interest we have recognized historically has never required a recording of the contingent liability for such revenue. The current revenue recognition practices and disclosure requirements provide meaningful and timely information to users of the financial statements.

## **Matching of expense**

It is common for investment managers to enter into compensation arrangement with employees, in which the compensation plans are aligned with performance-based fees earned in managing private equity funds. Therefore, if the Board does not consider the impacts of such associated

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compensation arrangements, which are tied to the performance-based fees there will be a resulting mismatch of revenue and expense, if the recognition criteria for these performance-based fees, is based on a reasonably assured threshold. A disconnect could exist if the liability booked for the associated compensation arrangements meets the "probable" criteria established under ASC 450. We believe the continued recognition of revenue under the liquidation method paired with the related compensation expense reflects the underlying economics of the transaction.

**Summary** 

In order to provide the most meaningful financial information related to performance-based fees in the private equity asset management industry, recognition of performance-based fees should be permitted based on the cumulative underlying fund performance to date. This approach allows an accurate matching of the associated compensation expense with the revenue recognized, which is aligned with the performance-based fee arrangements.

Thank you for considering these comments. Please feel free to contact me should you have any questions or wish to discuss my thoughts on the current proposal.

Sincerely,

Bruce Meikle Senior Vice President and Principal Financial Officer The Capital Group Companies, Inc.

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