



March 13, 2012

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

Dear Board Members:

Consejo Mexicano de Normas de Información Financiera (CINIF), the accounting standard setting body in Mexico, welcomes the opportunity to submit its comments on Exposure Draft ED/2011/6 regarding *Revenues from Contracts with Customers* (the 2011 ED), issued in November 2011. Set forth below you will find our comments on the 2011 ED, as well as our responses to the specific questions included therein.

We have divided our letter into three sections. In the first section you will find our general comments on the 2011 ED. The second section includes our responses to the specific questions raised in the 2011 ED. The third section includes some additional observations on the 2011 ED.

General comments on the 2011 ED

We are very pleased to see the constructive reaction of the IASB to the many comment letters received in response to the initial exposure draft in 2010 on *Revenues from Contracts with Customers* (the 2010 ED). In general, we view the amendments to the initial proposal to be positive and responsive to users of IFRS. This second version of the revenue recognition proposal comes much closer to achieving the stated project objectives of improving financial reporting of creating a common revenue recognition standard for IFRS and US GAAP that clarifies the principles for recognizing revenue that can be applied consistently across various transactions, industries and capital markets.

However, we are uncertain that some of the provisions of the 2011 ED will actually improve financial reporting, specifically with respect to:

- Allocation of the total transaction price to all separate performance obligations in a contract in proportion to the standalone selling price of the good or service underlying each of the performance obligations without considering the economic substance of how the individual elements within a bundled arrangement have been priced. This can result in a loss on one part of a contract even when the contract as a whole is profitable. The exceptions included in paragraphs 75 and 76 of the 2011 ED are insufficient.

- Performance of the onerous test at the level of each individual performance obligation of a single contract with a customer.
- The excessive proposed disclosures for interim financial statements.
- We believe that clarification of the practical expedients added to the 2011 ED is required to establish whether they are options or requirements. We fear that many entities will use them without proper consideration of the relevant facts and circumstances.

Our responses to the specific questions raised in the 2011 ED

Question 1

Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

We agree with the revised guidance for determining when an entity satisfies a performance obligation over time and therefore recognizes revenues over time. The concept of the “continuous transfer of goods or services” in the 2010 ED was vague and would have been very difficult to put into practice. We agree with the basic principle that an asset that is created or enhanced must be controlled by the customer for a performance obligation to be satisfied over time. However, as indicated in paragraph BC92 of the 2011 ED, frequently it may not be clear whether there is a continuous transfer of control. The second criterion added to the 2011 ED regarding the alternative use to the entity adequately addresses that concern. During our outreach with one of the largest construction companies in Latin America, we were told that the revised guidance greatly alleviates their concerns about the ability to use the percentage-of-completion method of accounting.

Question 2

Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer’s credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer’s credit risk and why?

We agreed with the original proposal in the 2010 ED that the customer’s credit risk should reflect *how much* revenue an entity recognizes when it satisfies a performance obligation as opposed to *whether* an entity recognizes revenue, consistent with the expected loss concept to be included in IFRS 9, *Financial Instruments*. However, we also agree with the revised core principle that an entity should recognize revenue to depict the transfer or promised goods or services to a customer in an amount that reflects the consideration to which a company *expects to be entitled*, as opposed to *receives*, or *expects to receive*, in exchange for those goods or services, accompanied by recognition of an adjustment to recognize any expected loss in a separate line item adjacent to the revenue line item, thereby resulting in the same net revenue amount as in the original proposal.

Question 3

Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognizes to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognize for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

We are glad to see that an alternative to the mandatory probability-weighted amount of consideration in the 2010 ED has been identified and introduced in the 2011 ED. We agree with that alternative, the most likely amount, since it addresses a concern that in many cases the probability-weighted amount will never be the amount ultimately to be received by the entity.

We also agree with constraining the cumulative amount of revenue that may be recognized based on the entity's experience and the predictability of such experience. Both the entity's ability to estimate the transaction price (the 2010 ED) and the reasonable assurance of entitlement (the 2011 ED) require that an entity have experience with similar types of performance obligations. We agree this is essential for the recognition of variable consideration.

Question 4

For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognize a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

We do not agree with the proposed scope of the onerous performance obligation test for two reasons.

First, we do not believe the onerous test should be made at the level of each individual performance obligation of a single contract with a customer. This can result in ignoring the economic substance of how the individual elements within the bundled arrangement have been priced. Consider the following example, assuming the seller can demonstrate that the license and maintenance services are separate performance obligations as defined in the 2011 ED:

	Standalone prices		Bundled arrangement	Allocation per 2011 ED		
	Product license	Maintenance services		Product license	Maintenance services	Total
Selling price	\$100,000	\$100,000	\$160,000	\$80,000	\$80,000	\$160,000
Cost	35,000	85,000	120,000	35,000	85,000	120,000
Margin	\$65,000	\$15,000	\$40,000	\$55,000	(\$5,000)	\$40,000
Margin %	65%	15%	25%	69%	(6%)	25%

Unless the entity can allocate the discount entirely to the product license performance obligation pursuant to the criteria of paragraph 75 of the 2011 ED, which often may not be possible, as the transaction price allocation method established in the 2011 ED ignores the economic substance of how the individual elements within the bundled arrangement have been priced, it results in an apparent onerous performance obligation at contract inception for the maintenance performance obligation. However, we do not believe that an onerous performance obligation exists in this case.

We believe that a better transaction price allocation approach would be to consider the bundled arrangement as a separate product and that the bundled profit margin be maintained for each performance obligation, as follows:

	Standalone prices			Proposed revised allocation		
	Product license	Maintenance services	Bundled arrangement	Product license	Maintenance services	Total
Selling price	\$100,000	\$100,000	\$160,000	\$47,000	\$113,000	\$160,000
Cost	35,000	85,000	120,000	35,000	85,000	120,000
Margin	\$65,000	\$15,000	\$40,000	\$12,000	\$28,000	\$40,000
Margin %	65%	15%	25%	25%	25%	25%

We wonder if the selling price of the maintenance services should not be capped, since as you can see in the example provided above, the transaction price allocated to such services is greater than the standalone selling price due to the bundled margin being greater than the standalone margin. In that case, \$13,000 would be reallocated to the product license, resulting in a 42% margin on the product license and maintaining the 15% margin on the maintenance services.

During our outreach with the largest telecommunications entity in Latin America, we were told that the proposed transaction price allocation methodology would represent a significant burden and may prove to be operationally impractical. That company has hundreds of different packages for thousands of customers that include multiple combinations of five different services (called “plays”). They believe additional alternative allocations methodologies are required for their industry in order to comply with the objectives of the 2011 ED.

Secondly, we do not believe an onerous performance obligation should necessarily be a performance obligation that the entity expects to satisfy over a period of time greater than one year. We would appreciate clarification as to whether it is acceptable to recognize a liability for an onerous performance obligation that an entity expects at contract inception to satisfy over a period of time of less than one year, since we believe that such analysis should be carried out for all contracts having material onerous performance obligations, irrespective of their duration, especially if some of the performance obligations will be satisfied in subsequent reporting periods. Our proposed alternative methodology to allocate the transaction price described above appropriately removes the unintended consequences for many contracts.

Accordingly, while we agree that the onerous performance obligation test should be applied to performance obligations that an entity satisfies over time, we believe the economic substance of how the individual elements within a bundled arrangement have been priced must be considered. This issue is specifically addressed in BC186 of the 2011 ED, including consideration of a profit margin approach. However, we do not believe the exceptions discussed in paragraphs 75 and 76 of the 2011 ED are sufficient.

Question 5

The Boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports.* The disclosures that would be required (if material) are:

- The disaggregation of revenue (paragraphs 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- An analysis of the entity's remaining performance obligations (paragraphs 119–121)
- Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
- A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfill a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.

Except for the first disclosure related to the disaggregation of revenue, we do not agree that the proposed disclosures mentioned above should be required in interim financial statements. As stated in paragraph 6 of IAS 34, *Interim Financial Reporting*, "The interim financial report is intended to provide an update on the latest complete set of annual financial statements. Accordingly, it focuses on new activities, events, and circumstances and does not duplicate information previously reported." Accordingly, unless the disclosures mentioned above would present significant changes from the equivalent disclosures in the latest complete set of annual financial statements, we question the cost-benefit of requiring the inclusion of such disclosures in interim financial statements.

During our outreach with one of the largest construction companies in Latin America, we were told that the proposed level of quarterly disclosures would represent a significant burden due to the brief period available for the preparation of quarterly reports.

Question 6

For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset. Do you agree that an entity should apply the

proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

We agree that the revised and enhanced revenue recognition guidelines in the 2011 ED should be applied to transfers of non-financial assets that are not an output of an entity's ordinary activities.

Additional observations on the 2011 ED

Paragraph 3 – In the core principle we recommend that the IASB consider replacing the word “transfer” with “delivery” to emphasize the permanence of the transfer from the entity to the customer. The term “transfer” suggests either a temporary or a permanent conveyance of goods, while “delivery” suggests permanent conveyance. This same change should be considered in the definition of a performance obligation in Appendix A, wherein we suggest replacing “transfer” with “deliver”.

Paragraph 60 – This paragraph includes a practical expedient regarding the need for adjustment of the promised amount of consideration to reflect the time value of money. This paragraph states that no adjustment is necessary if the entity expects at contract inception that the period between payment by the customer of all or substantially all of the promised consideration and the transfer of the promised goods or services to the customer will be one year or less. In some jurisdictions, generally developing countries, where high interest rates often exist, the one-year practical expedient could result in the failure to recognize significant required adjustments. We believe this practical expedient should be eliminated and replaced by a requirement to adjust the promised amount of consideration to reflect the time value of money when the effect is deemed to be significant.

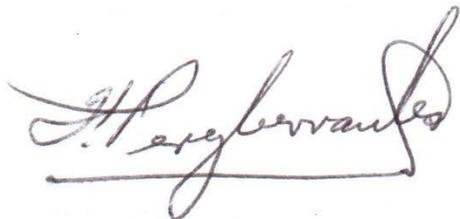
Paragraph 65 – This paragraph introduces the section on “Consideration payable to a customer” in the form of cash, credit or other items that the customer can apply against amounts owed to the entity, but it does not address situations where an entity provides a customer with cash or other items to facilitate or stimulate the resale of its products without the ability of the customer to apply such items against amounts owed to the entity. These can be in the form of “slotting fees” or “buydowns” (see ASC 605-50-20 of US GAAP). According to ASC 605-50-45-4 of US GAAP, these items should also be presented as a reduction of revenue. We recommend that these items be addressed in the new standard.

Appendix A – We observe that in the IASB's ED *Revenue* is defined using the previous definition of *Income*, while in the FASB's ED they are combined into a single definition of *Revenue*. In this regard, we prefer the FASB's approach and believe the definition of *Income* should be eliminated and incorporated into the definition of *Revenue*.

Illustrative Examples – In general, the Illustrative Examples do a very good job of explaining the proposals and making them operational. However, we believe the required journal entries, as presented in Examples 9, 17 and 18, would prove very useful in other examples, such as Examples 19, 20, 24 and 25, to ensure proper application of the guidance.

Should you require additional information on our comments listed above, please contact William Biese at (52) 55 5596 5633 ext. 113 or me at ext. 103 or by e-mail at wbiese@cinif.org.mx or fperezcervantes@cinif.org.mx, respectively.

Sincerely,

A handwritten signature in dark ink, appearing to read 'F. Perez Cervantes', with a long horizontal flourish underneath.

C.P.C. Felipe Perez Cervantes
President of the Mexican Financial Reporting Standards Board
Consejo Mexicano de Normas de Información Financiera (CINIF)