August 18, 2015

Russ Golden  
Chair  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856-5116  
United States  

Re: Comment Letter on Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing

Dear Mr. Golden,

The CFA Institute, in consultation with its Corporate Disclosure Policy Council (“CDPC”), appreciates the opportunity to comment on the Financial Accounting Standards Board (“FASB”) Exposure Draft, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing (the “Exposure Document” or “ED”). These amendments relate to Topic 606, Revenue from Contracts with Customers, of the Accounting Standards Codification that was issued as part of the convergence project on revenue from contracts with customers by the FASB and International Accounting Standards Boards (collectively, the “Boards”).

CFA Institute is comprised of more than 130,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures provided to investors and other end users is of high quality.

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1 With offices in Charlottesville, New York, London, Brussels, Hong Kong, Mumbai, Beijing, CFA Institute is a global, not-for-profit professional association of more than 130,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 150 countries, of whom nearly 123,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 144 member societies in 69 countries and territories.

2 The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners’ perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.
OVERVIEW

As we consider the proposed changes, four key concerns permeated our thinking with respect to the proposed modifications. They are as follows:

1) **Need to Safeguard Convergence Gains** – The revenue standard was the first successfully completed joint project between the FASB and IASB under the 2002 Memorandum of Understanding, and it has been widely lauded as the ‘poster child’ of successful convergence efforts by the Boards. The Boards should prioritize retaining the converged state of the standard to ensure that investors can benefit from globally comparable revenue reporting. Revenue recognition is so pervasive that the case for common standards is even more important than for other standards. To keep the standards converged, and to effectively engage with stakeholders, it would have also been highly desirable for the Boards to have aligned the language, timing and deliberations of any proposed changes to this revenue recognition standard. Unfortunately, unlike during the development of the final standard, there does not appear to be the same degree of collaboration between the Boards in respect of decisions related to the amendments as well as in the process of eliciting and deliberating on stakeholder feedback.

It is unclear why the same principles and language within IFRS and US GAAP requirements would, in some cases, be anticipated to result in country-specific differences in their interpretation while being applied towards similar economic situations/business models – especially if the principles are robustly articulated and accompanied by sufficient illustrative examples. While the same language within the revenue recognition principles of both US GAAP and IFRS may not guarantee consistent application, different language will certainly guarantee diversity in application across the standards. As a result of the non-aligned approaches by the Boards towards clarifying the final standard guidance, there is a high likelihood and near certainty of diverged IFRS versus US GAAP requirements and application in respect of some of the issues that were meant to be clarified (i.e. accounting treatment of after-sale shipping costs and licensing contracts). Said differently, while US GAAP may be seen to have been clarified by these amendments there is now a greater likelihood that there will be differences in interpretation between IFRS and US GAAP resulting in a lack of comparability for investors across jurisdictions.

It is also important to consider that the Securities and Exchange Commission (SEC) Chief Accountant has, in a recent speech, advocated for convergence as the way forward for achieving globally comparable standards. However, any emergent divergence on the revenue recognition standard – which thus far has been assumed to exemplify the first successful joint FASB-IASB convergence project – is likely to cast doubt on the plausibility of convergence as an effective mechanism of achieving global standards in the absence of any formal mechanisms or mandate for both Boards to pursue and maintain converged standards.

2) **Clarification of Guidance Should be the Focus** – The need for clarification and incremental implementation guidance from stakeholders is not surprising. As we observed in our 2013 comment letter response to the revised exposure draft, there were several aspects of the then
proposed five-step model that we believed needed further clarification including those related to identifying distinct performance obligations. Subsequent to the issuance of the final standard in May 2014, we expected that the joint revenue transition resource group would only focus on identifying areas of difficulties and possible misinterpretation in application of underlying principles. We did not expect the Boards to:
a) undertake the development of new core principles as seems to be the case with the licensing guidance; and/or
b) propose additional practical expedients or options, as is the case with the changes to the identification of significant performance obligations;
as these would amount to a *de facto* re-opening of the standard and would either ignore the outcomes or signal inefficiency of the preceding consultative and standards finalization processes.

At this stage of the due process, we expected the Boards to only emphasize the clarification of principles in a manner that reduces the possibility of diversity in practice within and across U.S. GAAP and IFRS reporting jurisdictions.

3) **Investor Outreach & Communication of Effects of Proposed Changes** – Revenue is one of, if not, the most critical performance measures for investors whilst analyzing and valuing companies. As such, any key changes to the revenue recognition requirements ought to, in all instances, be accompanied by an extensive outreach process to investors – outlining the nature and pervasiveness of facts and circumstances that necessitate any of the proposed changes and articulating the implications for existing revenue reporting (i.e. timing, amount and uncertainty of revenue). The need for investor outreach exists, even when changes relate to an already issued final standard – as is the case with the newly-issued revenue recognition standard. Unfortunately, the proposed amendments appear not to have been subject to a broad-based investor outreach. Additionally, the changes don’t appear to have been framed in a manner that makes the case for the amendments backed up by investors understanding of the implications and their agreement that the anticipated reporting outcomes would be a more faithful representation of affected business models (e.g. business models with shipping costs, licenses). In the absence of a robust investor-oriented outreach, there is a significant risk that investors will be left as puzzled ‘by-standers’ with regards to changes that could have broad ramifications on reporting outcomes.

The proposed late stage amendments risk far-reaching ramifications with limited investor input and scrutiny. For example, the proposed amendments address licensing revenue and whether this should be recognized at a point in time versus over time. As the [2012 Report on Intellectual Property and the US Economy](http://example.com) shows, licenses are a key component of revenues for a not-insignificant number of business models. Table 1, excerpted from the aforementioned 2012 report, highlights a selection of key industries with significant intellectual property (IP) intensive revenue. IP-intensive business models will likely become more pervasive in the knowledge economy. The changes being proposed related to revenue from licenses could have potentially widespread ramifications within and across a wide variety of industries. Therefore, the robustness of the proposed guidance is critical in the long-term. Rather than treating these licensing revenue-related amendments as minor tweaks
to a final standard or as a mere clarification of the core principles, effective standard-setting requires an education and outreach to investors on the anticipated impact of these amendments. Specifically, investors would benefit from knowing which IP-intensive sectors would have different patterns of revenue recognition if these amendments were not made and which would not. This would help investors assess whether from their point of view, these amendments will result in an improved pattern of revenue recognition across all industries or only in some.

### Table 1: Illustrative Disaggregation of IP Revenue for Selected Industries

<table>
<thead>
<tr>
<th>Sector</th>
<th>IP Related Revenue ($ millions)</th>
<th>IP Revenue Intensity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lessors of nonfinancial intangible assets</td>
<td>24,473</td>
<td>74.3%</td>
</tr>
<tr>
<td>Motion picture and video industries</td>
<td>51,132</td>
<td>64.1%</td>
</tr>
<tr>
<td>Cable and other subscription programming</td>
<td>17,256</td>
<td>38.4%</td>
</tr>
<tr>
<td>Software publishers</td>
<td>12,868</td>
<td>9.5%</td>
</tr>
<tr>
<td>Scientific research and development services</td>
<td>8,532</td>
<td>9.0%</td>
</tr>
</tbody>
</table>

IP Revenue Intensity = \( \frac{\text{IP Revenue}}{\text{Total Revenue}} \)

We also remain concerned about the limited discussion regarding the likely impact of the amendments on ‘identifying separate performance obligations’, relative to current reporting requirements. Investors would benefit from a clear articulation of the sectors that will have differences in their pattern of revenue recognition as result of these amendments related to separate performance obligations.

Overall, outreach to investors is necessary as there is minimal representation of investors at the joint revenue transition group and investors generally do not follow the efforts of transitional period focused groups. Furthermore, while some have suggested that these amendments are simply clarifications of FASB’s original intent, they appear more significant as to necessitate extensive investor outreach.

4) **Excessive Focus on Minimizing Cost and Compliance Complexity** – Financial reporting ought to simply mirror the economic reality of the reporting entity and complex contractual arrangements may necessitate relatively complex accounting requirements. That said, these amendments seem to be heavily motivated by the need to reduce preparer cost and compliance complexity. The focus of the changes seems to be either to assuage concerns from preparers and auditors related to departure from current practice or to reduce the expected cost of complying with the new standard – rather than on attaining conceptually robust and economically relevant reporting. Standard setters should be extremely cautious when providing relief from the final standards’ requirements based on generalized claims of higher costs and application complexity. An excessive emphasis on costs (ultimately all borne by investors) can shift the focus away from the objectives of transparent, comparable, and faithfully representational information. We recommend that the principal considerations
for these amendments ought to be the improved depiction of economically relevant events and comparable reporting, and not primarily minimizing costs.

SPECIFIC RESPONSE TO EXPOSURE DRAFT QUESTIONS

The key amendments proposed in the Exposure Draft are related to: a) identifying separate performance obligations; and b) updating the licensing guidance. Rather than directly respond to the eight questions posed within the ED, our comments below focus on important investor considerations around these amendments.

Identifying Separate Performance Obligations Amendments

Investors have an interest in the judgments involved in identifying separate performance obligations within customer contracts as these judgments can affect the amount and timing of revenue depending on the timing of delivery of the distinct goods or services. Identifying separate performance obligations is necessary for multiple-element sales that are comprised of distinct goods, services and other promises implied by customary business practices. Identifying separate performance obligations is an essential step required prior to allocating the transaction price (customer consideration) and recognizing revenue. The key amendments proposed in the ED with respect to identifying performance obligations relate to the following areas:

- Developing a materiality assessment in determining distinct performance obligations;
- Providing an election on the treatment of after-sale shipping costs;
- Assessing distinct performance obligations in the context of a contract; and
- Offering an election on accounting for a series of performance obligations.

Our comments below relate to these key amendments.

Distinct Performance Obligations: Proposed Materiality Yardstick Incorporates Materiality In New Way & Does Not Clarify Nature of Performance Obligation

Under the proposed amendment, while assessing the distinct performance obligations within customer contracts, companies will need to consider whether these distinct performance obligations are material in the ‘context of the contract’. The notion of assessing materiality in the context of contract is a novel approach towards applying existing materiality principles. As we understand, the amendment was motivated by auditor and preparer concerns regarding the identification of incremental distinct performance obligations relative to current guidance and queries as to whether there was a departure from existing SEC requirements that provide a framework for the determination of immaterial performance obligations.

As we understand, Revenue Transition Resource Group (TRG) members sought to clarify whether the stipulated treatment of revenue adjustments (e.g. marketing incentives, warranties), under the standard, would result in incremental distinct performance obligations relative to current practice. In a similar vein, in our 2013 comment letter on the Revised ED we noted that neither the 2009 Discussion Paper nor the 2011 Original ED on Revenue for Contracts with
Customers made it readily apparent to investors as to which revenue adjustments were distinct performance obligations and which were simply revenue reductions.

In response to stakeholder queries, we expected the Boards to clarify, where appropriate, the nature of certain items that necessitates their treatment as distinct performance obligations. We do not consider the inclusion of a materiality assessment criterion within the standard to be a conceptual clarification regarding the nature of these items. Further, we believe that assessing materiality in the context of the contract adds a new layer of judgment to the application of the materiality principle as is currently required. As Messrs. Linsmeier and Siegel point out in their dissent, it will be hard to justify the confinement of such a judgment to only the revenue recognition standard. We agree with the dissenting view and believe that the application of the materiality principle ought to be a cross-cutting issue addressed in the conceptual framework.

**After-Sale Shipping Costs:**

_Election Undermines Comparability and Economic Relevance of Revenue_

Under the proposed amendments, reporting entities can elect not to treat after-sales shipping costs as a separate performance obligation and instead treat them as part of the order fulfillment process. We strongly agree with the alternative view expressed by Messrs. Linsmeier and Siegel to the effect that the ability for companies to elect to recognize after-sale shipping costs as part of the original sale has an adverse effect on comparability of companies. We do not support these added options because accounting options undermine comparability of reporting outcomes and are a principle root cause of avoidable complexity within financial reporting.

Furthermore, different types of customer contracts would motivate the need for the seller to have to provide shipping services either before or after sale. Economically, the nature of shipping services provided after a sale and transfer of control of a good to a customer is inherently different from shipping services that are part of the order fulfillment. Furthermore, shipping costs influence customers’ purchase decisions. Consequently, many business models (e.g. Amazon) compete against their rivals based on the differentiated nature and efficiency of their supply chain management processes of which shipping and related costs is a key component. The accounting requirements ought to reflect the distinct characteristics of FOB-shipping point vs. FOB-destination contracts. Allowing entities to elect to report after-sale shipping costs as being part of order fulfillment will likely result in a distorted and non-comparable representation of economic reality. Finally, if this amendment is adopted, we would expect the Board to specify an additional required disclosure of the amount of and the reporting choice for after-sale shipping costs, to enable investors to compare companies that may have similar business models but elect to apply different recognition approaches for their after sale shipping costs.

_Assessing Distinct Promises in Context of Contract: Need Effects Analysis & Disclosures_

The issued final standard requires assessment of whether a promise or performance obligation is distinct in the context of the contract with the customer (i.e. not integrated with delivery of other goods or services). The ED proposes an amendment that aims to clarify the notion of ‘significant integration in the context of contract’ such that a seemingly distinct performance obligation (i.e. promise of good or service) needs to be assessed as to whether it is part of a combined single performance obligation.
The ED amendments aim to clarify this principle and provide some helpful additional illustrative examples of application of this criterion. However, the language modification seems to potentially increase the number of required judgments and to mostly provide a greater amount of latitude for preparers to avoid having to identify multiple distinct performance obligations. In our previous comment letters, we expressed our concerns about the potential subjectivity in the steps of identifying distinct performance obligations and allocating the transaction price. Overall, it is hard for investors to fully assess the internal consistency of the Board’s conclusions regarding the application of principles relative to its prior conclusions and whether the previous and current ED’s illustrative examples provide consistent judgments on whether a distinct performance obligation exists within a contract. A piecemeal articulation of additional indicators could risk potentially adding to the overall lack of stakeholder clarity regarding these judgments.

To help investors compare and assess impacts of identifying performance obligations, we propose:

- **Requiring Disclosures Related to Any Additional Management Judgments**: There is an inherent risk of increased incomparability of reporting entities due to the additional entity-specific judgments within a fairly labyrinthine decision process of determining whether there are, within a contract: a) distinct promises of goods or services, or b) multiple goods or services are simply part of a single promise. The multiple entity-specific judgments require robust disclosures and we would have expected any amendment that increases judgments to have also specified required additional disclosures.

- **Performing Effects Analysis**: Given that identifying performance obligations has a significant impact on the amount and timing of revenue for business models with complex and multiple-element contractual arrangements, there is need for both Boards to undertake and communicate an effects analysis to help investors anticipate the sectors where the patterns of revenue recognition may change due to the updated guidance.

**Accounting Treatment for Series of Distinct Performance Obligations: Need for Effects Analysis**

Under the proposed amendments, reporting entities can elect to recognize a series of performance obligations as either a single performance obligation or as distinct performance obligations. Naturally, the preparers who raised the matter to the TRG would be fully abreast on the specificities of the challenges that they anticipate with the application of the issued final standard guidance. However, the largely conceptual articulation of this issue does not readily lend itself to the elicitation of investor feedback. Therefore, as part of investor outreach on these proposed amendments, we recommend the articulation of the business sectors affected and an illustration of if/why the proposed options in accounting for a series of distinct performance obligations do not impact the comparability of reporting outcomes across similar business models.

**Licensing Guidance Amendments**

The core principle enunciated in the issued final standard is that the assessment of whether a customer has either a right to access or right to use an entity’s IP, depends on whether the seller undertakes (or, would be expected to undertake) activities that significantly affect the IP to which the customer has rights.
Overall, the proposed guidance focuses on the nature of the IP and new concepts such as a distinction between functional and symbolic licenses are proposed. The ED deals with the following:

- **New Criteria Based on Nature of License**: There is a required distinction on the nature of license (functional versus symbolic) as an additional consideration for determining whether the license provides either:
  a) ‘right of access’ and recognition of revenue over time (symbolic licenses) or
  b) ‘right of use’ and recognition of revenue at a point in time (functional licenses),

- **Clarifies Scope of License Related Amendments**: The issued final standard includes implementation guidance on when to recognize revenue for sales-based or usage-based royalties promised in exchange for a license of intellectual property. As we understand, there have been varied interpretations of the applicability of royalties’ constraint in respect of multiple-element contracts that include varied proportions of license and non-license related revenue. The ED clarifies that the licensing requirement applies to sales-based and usage-based royalty arrangements, whenever the “predominant” item to which the royalty relates is a license of IP. An entity would not split a sales-based or usage-based royalty into a portion subject to the guidance on sales-based and usage-based royalties and a portion that is not subject to that guidance.

### Need to Outline Implications Across Sectors of Update on Licensing Guidance

There is a required distinction of the nature of license (functional vs. symbolic) as an additional consideration for determining whether to recognize revenue over time or at a point in time. Though coming to different conclusions regarding the robustness of the updated criteria, the basis of conclusion and the alternative view arguments are helpful in their elaboration on the notion of ‘standalone functionality’ of licenses (i.e. ability to process a transaction, perform a function or task, or be played or aired) and clarifying that these apply to software, biological compounds or drug formulas, completed media content (films, television shows or music) and patents to specialized manufacturing process.

We generally agree that standalone functionality of a license warrants full revenue recognition at the time of sale. However, as the amendments have largely been articulated at a conceptual level, it is hard for investors to evaluate the robustness, exhaustiveness and mutual exclusivity of the functional vs. symbolic categorization and to identify where changes from current reporting are bound to occur. As noted earlier, there is need for education and outreach to investors on the anticipated impact of these amendments. Specifically, investors would benefit from knowing which IP-intensive sectors would have different patterns of revenue recognition if these amendments were not made and which would not.

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3 The issued final standard has stipulated a royalties’ income recognition constraint for IP licenses. In other words, if there is a license of IP for which the consideration is based on a customer’s subsequent sales or usage, an entity should not recognize any revenue for the variable amounts until the uncertainty is resolved. Revenue derived from a sales-based or usage-based royalty is not recognized until the later of a) the customer’s subsequent sales or usage occurs or b) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).
Boards Should work to Maintain Converged Licensing Guidance

As expressed in the alternative view, there is a risk that the proposed functional versus symbolic distinction will end up overriding or creating an alternative to the core principle of the converged final standard – where there was always a need to assess whether the seller of a license undertakes activities (e.g. provide maintenance and support services) that affect the utility of the IP to which customer has rights without resulting in a transfer of a good or service to the customer, prior to determining whether to recognize revenue at a point in time versus over time. As we understand it, the proposed categorization could dispense with the need for preparers to make this assessment while reporting under US GAAP. This could result in divergence from IFRS and contribute to globally incomparable reporting of revenue.

Overall, we recommend and encourage both Boards to make adequate efforts to update their requirements in a manner that retains the converged licensing requirements and to only pursue amendments that are backed by extensive and robust investor outreach, scrutiny and feedback.

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Thank you again for the opportunity to comment on the ED. If you or your staff have questions or seek further elaboration of our views, please contact either Vincent Papa, PhD, CFA, by phone at +44.207.330.9521, or by e-mail at vincent.papa@cfainstitute.org or Sandra J. Peters, CPA, CFA by phone at +1.212.754.8350 or by email at sandra.peters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters                      /s/ Ashwinpaul C. Sondhi
Sandra J. Peters, CPA, CFA               Ashwinpaul C. Sondhi
Head, Financial Reporting Policy        Chair
Standards & Financial Markets Integrity Division
CFA Institute

cc:  Corporate Disclosure Policy Council
     Hans Hoogervorst, Chair, International Accounting Standards Board