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Group Accounting Policy

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## **Discussion Paper, *Preliminary Views on Revenue Recognition in Contracts with Customers***

Dear Mr. Rees:

UBS AG appreciates the opportunity to comment on the International Accounting Standards Board's and the Financial Accounting Standards Board's Discussion Paper, *Preliminary Views on Revenue Recognition in Contracts with Customers* (the DP). UBS is a multinational financial services firm that prepares its group consolidated reporting in accordance with International Financial Reporting Standards. We also have several significant US subsidiaries that prepare stand alone financial reports in accordance with US GAAP. As such, we recognize the value in reducing the current accounting complexity regarding revenue recognition. We also appreciate the boards' efforts to fully converge the accounting through the development and issuance of a joint standard. However, we do have some reservations about the DP that we would like to raise.

In an effort to converge, UBS believes that the DP offers a significant improvement over current US GAAP by greatly reducing the accounting literature from sources in excess of one hundred down to a single revenue recognition model. The need to issue a replacement standard on revenue recognition for IFRS is not as persuasive as IAS 11, *Construction Contracts*, and IAS 18, *Revenue*, are functioning principles-based standards already in place. In light of the benefits of convergence, however, we believe that a joint standard is necessary.

### **Scope**

In the DP, the boards indicated that scope was not established, which left open the possibility that the model could be applied to financial instruments, insurance contracts, and leasing contracts. While we realize that this is unlikely given the boards' other projects on these topics, we believe that the application of the DP's approach to revenue recognition for financial instruments, leases, and insurance contracts would raise a number of application issues due to the significant change in accounting from current IFRS and would likely not provide more decision-useful information for users. In addition, the issue of uncertain consideration has not been properly addressed. These are currently some of the most problematic areas of revenue recognition. Until these scope issues are clarified, the intended goal of establishing a single approach for revenue recognition is not achieved.

### **Contract-based revenue recognition model**

UBS supports the concept of a contract-based revenue recognition model. We believe this is the basis for the current revenue recognition guidance and believe that it is the most appropriate basis for revenue recognition going forward.

**Definition of a contract**

UBS believes that a contract is appropriately defined as “an agreement between two or more parties that creates enforceable obligations.” We believe it is appropriate because it is easily understood and appears to be capable of accommodating jurisdictional differences. It is important to note that, due to its dependence on the legal concept of “enforceability”, there is the possibility that a similar agreement in two different legal jurisdictions will be accounted for differently despite similar economic substance.

**Definition of performance obligations**

UBS believes that the proposed definition of a performance obligation is appropriate. We believe that identifying specific performance obligations, however, may present practical difficulties. It is unclear in the DP how and whether to separate performance obligations when they are interdependent. However, additional guidance on identifying multiple deliverables may alleviate this issue. It is important to note that we expect, if deliverables are interdependent and cannot be meaningfully separated, they will not be required to be separated.

**Transfer of control concept**

UBS does not believe that the transfer-of-control concept is sufficiently explained in order to apply in practice. This concept is also central to identifying the existence of and separating multiple performance obligations within a contract under the DP. Additionally, the transfer of control is the trigger for identifying when revenue is to be recognized under the DP. We do not believe that, in many contracts, control is passed from a vendor to a customer at one moment in time, but rather over the course of the performance of the obligation. For instance, we believe that the control of fund management services are passed to a client over the course of the contract period, requiring the systematic recognition of revenue based on the passage of time.

UBS believes that the focus on the transfer of control may raise issues when the transfer of an asset is other than when the economic benefit accretes to the customer. An example of such a situation is a fund in which the customer cedes control and access to its investment during the period in which the fund is closed. The fund manager may earn management fees by delivering management services, but the customer does not have control of the services until the time at which the fund is liquidated. This would indicate that the fund manager cannot recognize revenue on the contract until control passes to the customer, despite the customer bearing the economic risks and rewards of ownership. We believe that control passes as the services are rendered because the customer accretes a benefit from the management services despite not having current control over the underlying assets in the fund. This concept would benefit from additional discussion in the DP.

We note that the concepts described above represent a mechanism for recognizing revenue based on when value is delivered to a customer. This concept is similar to draft comments prepared by the European Financial Reporting Advisory Group in response to the DP. We believe that the delivery of value may be a more appropriate trigger for revenue recognition than a trigger based on control.

We would also like to raise the issue of optional control features. It is unclear to us how optional control features in contracts would impact the analysis.

**Other obligations**

UBS believes that obligations to accept returns and make refunds are performance obligations as it is defined in the DP. This is because the obligation to accept the good and refund the consideration is an unsatisfied obligation of the provider. However, we believe the measurement of these obligations will necessarily be heavily reliant on estimates based on preparers’ experience and expectations. We do note that the obligations, in many cases, can be and are transferred to an unrelated entity that is not otherwise a party to the contract.

**Uncertain consideration**

The DP states that the issue of uncertain consideration has not yet been addressed, and due to its significance in many contracts in the financial industry, we believe that the DP is incomplete in this respect. However, we understand that the boards are considering several different approaches to accounting for uncertain consideration and we believe that due to the potential impact on current accounting, it is appropriate to provide some feedback on that issue in this letter.

For a revenue recognition model to provide the most decision-useful information, it must allow some recognition of uncertain consideration to enable users to understand revenues earned by the reporting entity during the period. Based on this premise, entities should make an estimate/calculation of what revenue has been earned at each reporting date based on available information. We understand that in the boards' deliberations there is a view to delay revenue recognition until all uncertainties are resolved. We believe this would be misleading and inappropriate.

**Conclusion**

The issues cited above lead UBS to conclude that significant work is still required on the DP and that control-based revenue recognition does not reflect the manner in which value is transferred to a customer under a contract. Our concern is that constraining the recognition of revenue on the basis of control distorts the economics of the transactions.

Once again, we greatly appreciate the opportunity to comment on the very important issues discussed in the DP. If you would like to discuss any comments that we have made, please do not hesitate to contact Ralph Odermatt at +41 44-234-8410 or John Gallagher, +1 203-719-4212.

Regards,

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