Hermes Equity Ownership Services

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Financial Accounting Standards 401 Merritt 7 Norwalk, Connecticut 06856 United States of America

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Dear Board Members.

Re: Exposure Draft - Revenue from Contracts with Customers, revised

We welcome the opportunity to comment on the revised Exposure Draft on Revenue from Contracts with Customers. We welcome the changes which the Boards have made to their proposals following feedback. We believe that the revised ED is a considerable improvement, and we have only limited comments on how the proposals might be further improved.

By way of background, Hermes is a leading asset manager in the City of London. As part of our Equity Ownership Service (Hermes EOS), we also respond to consultations on behalf of many clients from around the world, including the British Coal Staff Superannuation Scheme, the BT Pension Scheme, the Lothian Pension Fund and the Mineworkers Pension Fund of the UK, the USA's Highland Good Steward, the National Pension Reserve Fund of Ireland, Stichting Pensioenfonds PNO Media of the Netherlands, Canada's Public Sector Pension Investment Board and VicSuper of Australia (only those clients which have expressly given their support to this response are listed here). In all, EOS advises clients with regard to assets worth a total of \$138 billion (as at December 31st 2011).

We answer the boards' specific questions below.

Yours sincerely,

Paul Lee Director



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?

Yes, we support the proposal. We support the risks and rewards analysis to help determine ownership of assets. We welcome this addition to the indicators of when control is transferred and believe it provides a pragmatic approach to the issue.

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?

Yes, we strongly support these proposals to disaggregate credit risk from the transaction price, and believe that this is the most significant positive advance in the revised ED. However, we are not sure that bad debt expenses will always need to be presented as a separate P&L item; we would prefer that materiality considerations be applied and that disclosure only be required when losses from bad debts are material.

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 recognises 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 recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

We welcome the application of the indicators in Paragraph 82, and believe the use of the stronger phrase "reasonably assured" is helpful. We are also strongly supportive of the use of a 'most likely' amount rather than a probability weighting to estimate variable consideration when it is more predictive of the amount the entity is entitled to receive. In many cases (not least where the outcome of a situation is binary), probability weighting will result in a reported figure that does not match any of the potential outcomes, as well as introducing very subjective judgments when assessing probabilities - such subjective judgements rarely being susceptible to audit. The 'most likely' result will also require subjective judgements, and therefore there will be a need for clear disclosures of assumptions and sensitivities.

Question 4: For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period...greater than one year, paragraph 86 states that the entity should recognise 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 agree that the onerous contract test should only be applied to contracts lasting more than 12 months. We do believe that onerous obligations should be assessed at the contract, not the performance obligation, level. We would want the separate elements within a single contract, only some of which are onerous, to be netted off against each other; to do otherwise would provide users with wholly misleading information.

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 fulfil a contract with a customer (par 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.

We firmly support the reduction in the burden of detail sought in interim reports. Given that the aim is for companies to disclose material matters, we do not believe that a detailed list of expectations is productive; there is a severe risk that preparers and auditors focus on the list rather than the materiality requirement. This is a general risk, and while we know that the IASB is considering disclosures more generally we believe the simple aim must be to refocus attention on the materiality requirement rather than detailed lists of disclosures which may need to be made but which tend to distract from the materiality requirement. We would therefore argue that this apparent level of prescription should be dropped from the standard, and that principles be used instead, seeking material disclosures of information that is necessary to understand the business model, how effectively it is being delivered and the development of performance in the company.

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?

It seems to us appropriate and sensible to apply the same transfer-of-control principle to such situations as well.