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September 14, 2012

Mr. Hans Hoogervorst Chair International Accounting Standards Board 30 Cannon Street London EC4M 6XH United Kingdom Ms. Leslie Seidman Chairman Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06865-5116 USA

Re: Comment Letter on Revision of Exposure Draft on Revenue from Contracts with Customers – Part II (Recognition & Measurement)

Dear Mr. Hoogervorst and Ms. Seidman,

The CFA Institute, ¹ in consultation with its Corporate Disclosure Policy Council ("CDPC")², appreciates the opportunity to comment on the International Accounting Standards Board's ("IASB") Exposure Draft ("IASB Exposure Draft" or "IASB ED"), *Revenue from Contracts with Customers*, and the Financial Accounting Standards Board's ("FASB") Proposed Accounting Standards Update, *Revenue from Contracts with Customers (Topic 605)*, ("FASB Proposed Update" or "FASB Update"). The IASB and FASB are collectively referred to as the Boards and the IASB ED and FASB Update are collectively referred to as the "Revised ED". The Revised ED is an update to the original exposure draft ("Original ED"), *Revenue from Contracts with Customers*, issued by the Boards in June 2010³.

CFA Institute is comprised of more than 100,000 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 the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

With offices in Charlottesville, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 108,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 139 countries, of whom nearly 99,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 58 countries and territories.

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.

³ CFA Institute issued a comment letter on the Original ED. A copy of this comment letter date 22 October 2010 may be found on our website at http://cfainstitute.org/Comment%20Letters/20101022_2.pdf.



OUR RESPONSE IS DIVIDED INTO TWO PARTS

We have divided our response to the Revised ED into two parts:

- Part I focuses on Disclosure, Presentation and Transition matters.
- Part II concentrates on Recognition and Measurement matters associated with the five steps in the revenue recognition model proposed by the Boards.

In our letter of 17 May 2012 we addressed disclosure, presentation and transition issues separately as we do not believe their importance to investors is garnering sufficient attention. Our concern is that revenue recognition, which is currently a "black box" to investors, will simply change to a different black box, with disclosures that are largely boilerplate and insufficient to enable investors to evaluate the choices made by preparers and the effects of those choices. A copy of that letter may be found at our website⁴. In the sections below, we provide an overview of our views regarding recognition and measurement matters associated with the Revised ED. Our detailed comments may be found in **Appendix.**

OVERARCHING OBSERVATIONS

We thank the IASB and FASB for the opportunity to comment on the Revised ED. Revenue is the starting point for the financial analysis of the income statement. Given the importance of revenue to investors, which we cannot overstate, it is essential that the Boards develop a sufficiently robust approach which can significantly improve current revenue recognition practices and in so doing provide investors with the information required to enable their evaluation of the amount, timing and uncertainty of revenue. The decision to refine the revenue recognition model is a step in the right direction. That said, we emphasize that this consultative and re-deliberation process should primarily aim to develop a conceptually robust revenue recognition model and not be simply an exercise in making limited adjustments to the Original ED proposals and developing practical expedients that move away from key principles.

Objective of Revenue Recognition Project

The stated objective of the revenue recognition project is to create a single, principles-based revenue recognition standard that improves accounting for contracts, multiple element arrangements, and other problematic areas that currently lack accounting standards. Paragraph IN2 states that the revenue project was initiated to clarify the principles for recognising revenue from customers and to develop a common standard under IFRS and US GAAP that would:

- Provide more useful information to users of financial statements through improved disclosure requirements;
- Remove inconsistencies and weaknesses in existing revenue standards;
- Provide a more robust framework for addressing revenue recognition issues as they arise;
- Improve comparability of revenue recognition practices across entities, industries, reporting jurisdictions and capital markets; and
- Simplify the preparation of financial statements by reducing the number of applicable standards to which an entity must refer.

⁴ CFA Institute 17 May 2012 Comment Letter on Revision of Exposure Draft on Revenue from Contracts with Customers – Part I (Disclosures, Presentation & Transition) (http://cfainstitute.org/Comment%20Letters/20120517.pdf)



As noted in our previous commentary, we also believe a revenue standard is required because:

- Under IFRS, there is a need for additional guidance to reduce the diversity of accounting practices across some similar business models. The diversity in practices arises from the conceptual inconsistencies and vagueness in requirements under the two revenue recognition standards (IAS 18, *Revenue*, and IAS 11, *Construction Contracts*) and the following interpretative releases:
 - IFRIC 13, Customer Loyalty Programs;
 - IFRIC 15, Agreements for the Construction of Real Estate;
 - IFRIC 18, Transfers of Assets from Customers; and
 - SIC 31, Revenue Barter Transactions Involving Advertising Services.
- IFRS standards do not adequately deal with separation of deliverables and allocation of revenue in multiple element arrangements and customer contract combination or modification for revenue recognition purposes. IAS 11 focuses on whether the different parts of a contract have been negotiated separately but IAS 18 is largely silent on when and how to sub-divide contracts for revenue recognition purposes.
- Under both US GAAP and IFRS there is little guidance for service activities and intellectual property transactions despite the increasing importance of industries such as technology, health care, and services that are among the fastest growing sectors worldwide.

Our assessment of the proposed improvements relative to current revenue reporting is based on our view as to whether the proposed model will result in the realization of the above stated objectives. We also assess the extent to which the Revised ED and the re-exposure model, relative to the Original ED, can better inform investors about the extent to which the amount and timing of reported revenue will reflect the economic reality of reporting entities.



Net Change from Original ED: Minimal Focus on Investor Considerations

Part of our assessment of the Revised ED was evaluating the differences from the Original ED. Relative to the Original ED, we would observe that the Revised ED includes the following changes:

- 1) Providing further guidance on performance obligations which are satisfied over time;
- 2) Dispensing with the segmentation of contracts;
- 3) Ceasing the use of profit margins as a means of identifying distinct performance obligations;
- 4) Focusing on entitled (an internal or management emphasis with little or no required external evidence) rather than expected consideration (to some extent, adjusted for market and customerspecific conditions related to collectability);
- 5) Requiring that the initial and subsequent measurement of credit risk be presented in the same line on the income statement and adjacent to gross revenue. The Revised ED's proposal will result in a move away from reflecting uncollectible revenue by adjusting 'when' or 'how much' gross revenue is reported. Thus, the adjacent presentation of uncollectible revenue a recognition and a measurement consideration is not just a presentation issue, as seems to be widely interpreted by many stakeholders;
- 6) Requiring warranties to be treated as distinct performance obligations only if sold separately;
- 7) Eliminating exclusivity as a criterion for determining the pattern of revenue recognition for intellectual property licenses; and

Providing disclosures regarding costs deferred that were lacking from the Original ED. Items 4 and 5 above and the costs that may be deferred (particularly, allowing deferral certain indirect costs) could increase opportunities for accelerating the amount and timing of revenue recognition and profit recognition (due to increased cost deferral).

Despite these proposed updates from the Original ED, we believe that the Revised ED changes are focused more on the requests of preparers than on the issues of importance to investors. Examples include the following:

- 1) Loss of key disclosure requirements in relation to the maturity of performance obligations;
- 2) Failing to add missing, yet important, disclosures as highlighted in our earlier letter;
- 3) Allowing additional practical expedients such as excluding loss recognition of onerous performance obligations that are satisfied at a point in time;
- 4) Allowing additional methods for estimating variable consideration, namely the inadequately defined 'most likely amount';
- 5) Including the concept of "reasonably assured" consideration without defining the term or providing disclosures related to its application.
- 6) For multiple-element arrangements:
 - a. the failure to strengthen the primacy of objective evidence when determining estimated selling price. Such objectivity could have been improved by specifying a hierarchy of objective evidence;
 - b. allowing the previously disallowed residual approach in estimating selling prices of distinct performance obligation that have highly variable or uncertain price information; and
 - c. granting discretion on the identification of distinct performance obligations where discounts can be allocated, rather than applying the default relative standalone selling price allocation.

The items listed above are not a complete itemization of the changes made between the Original ED and the Revised ED; however, our review of the Revised ED considered changes in each of the five steps of the revenue recognition model and the related presentation and disclosures. Overall, our view is that the net changes from the Original ED to the Revised ED provide preparers with a series of practical expedients that provide greater discretion on how to recognize revenue but that can be adverse to investor



interests. The Revised ED seems to focus on granting greater preparer flexibility to accelerate the amount and timing of revenue recognition with limited attention on what is best for investors.

Multiple Exceptions to Core Principles Within Model Reduces Likelihood of Comparable Accounting

There are multiple exceptions interwoven into the model. This could result in multiple and inconsistent interpretations of the guidance. Examples of the exceptions, practical expedients and multiple methods are shown in **Table 1** below. This existence of multiple exceptions reduces the likelihood of realizing the goal of greater comparability of reporting within and across companies and industries. It cannot be beneficial for investors if the number of exceptions to the core principle keeps increasing as has occurred within the Revised ED in comparison to the Original ED.

Table 1: Significant Exceptions to Core Principle, Practical Expedients and Multiple Methods

	eptions to Core Principle, Practical Expedients and Multiple Methods
Revenue Recognition Step	Exceptions to Core Principle, Practical Expedients and Multiple Methods
Identify Distinct Performance Obligations (Step #2)	The core principle of identifying separate performance obligations as outlined in Paragraph 28, is that a distinct performance obligation occurs when: a) goods or services can be sold separately; or b) a customer can benefit from a good or service on its own or together with goods or services that are readily available. However, — Paragraph 29, will allow companies to by-pass the criteria in Paragraph 28 if the contractual arrangements include interrelated goods or services that require significant integration and the bundle of goods or services is significantly customized, and — Paragraph 30 allows distinct performance obligations with the same pattern of transfer to be treated as a single performance obligation. Paragraph 30 has also been described as a practical expedient by IASB and FASB staff members during their outreach activities (e.g. FASB/IASB staff webcast held on 29 th February 2012).
Time Value Of Money Adjustment (Step #3)	Paragraphs 29 and 30 will effectively allow preparers to by-pass the core principle. The time value component arises when there is a difference in timing between the receipt of customer consideration and the satisfaction of the related performance obligation. However, a practical expedient exemption is being granted from the recognition of the time value component when the time difference between the receipt of customer consideration and satisfaction of performance obligation is shorter than one year.
Variable Consideration Measurement (Step #3)	There are two approaches allowed to estimate variable consideration, namely: a) probability weighted approach; and b) most likely amount. The application of the most likely amount has been allowed through the Revised ED. This optionality could create inconsistent measurement of revenue.
Estimated Selling Price Determination & Allocation of Transaction Price Across Distinct Performance Obligations (Step #4)	Estimated selling prices can be determined using: a) adjusted market values; b) cost plus margin methods; and c) residual approaches. As discussed in later sections, allowing the residual method of determining estimated selling price increases subjectivity of revenue. Allocation of transaction price is based on the allocation of relative stand-alone selling price as the default approach. In addition, the guidance allows discounts and contingent consideration to be allocated directly to separate performance obligations. The discretion to allocate discounts to separate performance obligations has been allowed in the Revised ED and could increase the subjectivity and incomparability of reported revenue.
Performance Obligations Satisfied Over Time (Step #5)	Satisfaction of performance obligations and recognition of revenue occurs when there is transfer of control to the customer of assets created by a company. The proposed criteria in Paragraph 35 (b) include entitlement to payment for performance to date if a contract is terminated. A condition of entitlement to payment can be met and revenue recognized, even though transfer of control of a good or service has not occurred. This could allow preparers to by-pass other transfer of control criteria and create circumstances where the terms of contracts related to payments may differentiate the accounting for economically similar transactions. The possibility of entitlement to payment occurring without transfer of control has also been highlighted in Tom Linsmeier's dissenting opinion contained in the basis of conclusion (i.e. Paragraphs AV6 and AV7).
Performance Obligations Satisfied Over Time (Step #5)	Measurement of progress toward satisfaction of performance obligations can be accomplished by using output or input methods. Output methods can be ignored if entities characterize observable data as being unreliable.



Onerous Performance Obligations	The recognition of losses from onerous performance obligations will not be required for: a)
	performance obligations satisfied at a point in time; and b) performance obligations satisfied over
	time for periods less than 12 months. These exemptions from loss recognition are being allowed as
	practical expedients. In addition, the discussion of allowing onerous performance obligation
	evaluation at the contract level is a violation of the core principle of recognizing revenue based on
	performance obligation as unit of account (i.e. identify and allocate transaction price to
	performance obligation).

Insufficient Development of Core Principles Reduces Likelihood of Comparable Accounting

There is also a need for strengthening of core principles discussed in response to the questions in the **Appendix**. Examples of areas that need strengthened principles include:

- Clarification of criteria to identify distinct performance obligations;
- Providing guidance for time value of money for performance obligations satisfied over time;
- Definition of reasonably assured for purposes of recognized variable consideration;
- Definition of most likely amount when estimating variable consideration, and clarification of criteria for performance obligations satisfied over time. Although, there is expansion in guidance provided for performance obligations that are satisfied over time, the Revised ED has also increased the number of exceptions to the core principle and lowered the likelihood of having an accounting framework that will yield relatively comparable accounting across most transactions and industries.

If the objective of the new standard is a reduction in the diversity of accounting practice and an increase in reporting quality, then the conceptual foundations should consist of robustly defined principles conveyed through unambiguous language and validated by sufficient guidance across the relevant industries that will be impacted.

Limited Information about Industry Impacts Puts Investors at Information Disadvantage

We reiterate the concerns we raised in our response to the Original ED regarding the limited information regarding industry effects. It is crucial for investors to understand the amount, impact and uncertainty of revenues across different industries. Thus far, there is relatively limited information within the Original ED or Revised ED, including the Illustrative Examples, regarding the anticipated impacts across a wide range of industries. The key issue for investors remains whether they can anticipate and differentiate industry impacts arising from each of the five steps of the revenue recognition model. Another remaining question is whether the proposed model, which is predicated on a highly principles based specification of requirements, will in the long-run, pre-empt the demand for and emergence of distinctive industry specific guidance. Further, in a U.S. context, enacting a principles-based standard and replacing the industry specific guidance under US GAAP may lead to decrease in the reliability and comparability of revenue recognition patterns of companies within particular industries.

We are concerned by the likely emergence of "shadow guidance" that articulates industry guidance by preparers and audit firms but to which investors have little or no access. We have seen the beginnings of such materials already and we are concerned that important interpretations may be made without input from investors or consideration of their needs, and for which disclosures will not be made. We believe that the Boards should provide implementation and/or interpretative guidance needed for specific industries rather than "outsourcing" that process to an informal process that lacks transparency. The lack of industry guidance appears to be contributing to many investors paying less attention than they should to the proposed revenue recognition changes.



Need to Ensure Cross-Project Consistency

We believe it is important for the Boards to evaluate and justify the cross project inconsistencies because there are a number of recurrent or cross-cutting issues with other key projects (e.g. lease, insurance and financial instruments). Examples of cross-cutting issues include:

- Transfer of control;
- Estimation of variable consideration;
- Application of discount rate;
- Principles of determining performance obligations that are satisfied over time;
- Meaningful distinction between goods, services and right of use of asset; and
- Principles of unbundling of distinct performance obligations.

Resolving these cross-cutting issues whilst deliberating on specific projects will contribute to the comparable accounting of all contracts and will enable a more efficient deployment of standard setting efforts. There should also be full conceptual consistency in the recognition and measurement approaches applied between the revenue recognition and leases project. For example, the measurement approach related to variable consideration should be consistent for both the leases and revenue recognition projects.

We also believe that the Boards need to have a better articulated framework regarding when and how cross-cutting issues will be addressed in other contractual arrangements that have been excluded from scope (i.e. research and development and other forms of collaborative arrangements; take-or-pay contracts; non-monetary exchanges with businesses with similar activities) and are not being addressed through any of the active projects (i.e. financial instruments, leases and insurance).



OVERALL OBSERVATIONS RELATED TO SPECIFIC REVENUE RECOGNITION STEPS

The **Appendix** provides a detailed discussion of our comments related to each of the revenue recognition steps and the questions posed in the Revised ED. Below is a summary of the contents of the **Appendix**.

Contract Definition Step Requires Further Practical Illustrations & Disclosure of Judgments (Step #1) The proposed model accords importance to the contract as a key building block. Identifying the contract with the customer is the proposed first step of the revenue recognition model. As we understand it, the contract definition helps to identify the entity's performance obligations to the customer and the related customer consideration. This step may have no consequences for most industries where contracts tend to be short-term, verbal or implied by customary business practice, but it is highly relevant for industries with long-duration and complex contracts. As a result, standard setters, and preparers may erroneously characterize this as a low impact step to investors simply because the revenue transactions of many business models do not require elaborate contracts. Step #1 has typically been presented as innocuous and one that should be glossed over. Yet, this step has multiple ways of significantly changing the amount and pattern of revenue recognized. For example, judgments made to combine or modify contracts could influence the amount and timing of revenue recognized and correspondingly increases the opportunities for earnings management.

The following shortcomings, which are more fully described in the **Appendix**, remain unresolved in the Revised ED:

- The Revised ED does not have explicit disclosure requirements related to contract definition judgments and related revenue impacts.
- The illustrative guidance fails to provide adequate examples that demonstrate the practical implementation challenges associated with applying this step of the proposed guidance. For example, although contract modification is a complex decision discussed further below, it is not clear which industries will be impacted most by such modification decisions. The Revised ED also fails to sufficiently delineate the interdependencies with other revenue recognition steps.
- There is limited information about the impact of contract terms on the recognition of revenue.

Multiple-Element Contracts Unbundling Guidance Needs Strengthening & Improved Communication (Step #2)

In our response to the Original ED, we articulated our concerns regarding the criteria for both unbundling distinct performance obligations and, thereafter, allocating the transaction price to distinct performance obligations. We agree with the decision not to apply profit margin when determining distinct performance obligations. Nevertheless, the current criteria of identifying distinct performance obligations under Paragraphs 28 to 30 are specified at such a high level that there is need for clarification of how and to which industries these criteria will apply. The current high level of specifying requirements makes it difficult for investors to evaluate whether and how earnings management opportunities are impacted by the proposed guidance. In effect, investors cannot effectively evaluate whether the amount, timing and uncertainty of revenue related to multiple element arrangements corresponds to the underlying economics and whether similar companies will measure revenue in a comparable fashion. The difficulty for investors to judge multiple element arrangements is compounded by the absence of disclosure requirements related to identifying separate performance obligations and by the generic, high level nature of disclosure requirements to the allocation of the transaction price.



In addition, the high level definition and optional application of the practical expedients specified in Paragraphs 28 and 30, could contribute to reduced comparability in the reported revenue of two companies that have engaged in similar revenue generating transactions.

Further, we believe it is necessary to better articulate the conceptual distinction between "revenue adjustments" which are considered distinct performance obligations and ones which are not.

Credit Risk (Step #3):

Adjacent Presentation of Credit Risk Improves Transparency of Revenue Credit Risk for Investors However, Greater Communication on the Nature of the Change from Existing Guidance Required

We are strongly supportive of the proposed adjacent presentation of credit as it increases the information content related to underlying gross revenue and impairments related to revenue. Adjacent presentation is also the only acceptable alternative to either the existing framework that has a recognition threshold based on credit risk or to the framework in the Original ED where how much of revenue was going to depend on credit risk. Commentators who object to the proposed presentation fail to sufficiently realize that at a minimum, gross revenue and credit risk have to be inextricably linked. It is also surprising that some preparers are objecting to a change that does not impose additional cost or compliance complexity and that many arguments against the change seem to be influenced by a preference towards sticking to familiar presentation requirements even at the expense of greater transparency.

As we elaborate on more extensively in the **Appendix**, greater communication of the nature of the change from existing guidance is necessary. The Boards' communication has not been crystal clear on the nature of the change. It has been presented to investors as solely a presentation change when, in fact, how revenue will be measured, and under what guidance that determination will be made, is changing.

Variable Consideration (Step #3):

Improvements Needed on the Definition & Measurement of Variable Consideration

The Revised ED proposes that if the amount of revenue to which an entity expects to be entitled is variable, the cumulative amount of revenue an entity recognizes to date shall not exceed the amount to which the entity is reasonably assured to be entitled. This new proposal represents a shift from the requirements in the Original ED, where the variable revenue was recognized if it could be 'reasonably estimated'. That said, there is need for several improvements to this concept as summarized below and expanded upon in the **Appendix**:

- Further conceptual development and clarification of the 'reasonable assurance' notion is necessary.
- There is also need for a conceptual distinction of variable, uncertain and contingent consideration.
- We are concerned that allowing both the 'expected value' and 'most likely amount' in the determination of variable consideration will increase the subjectivity of revenue reporting. We reiterate the view that we have severally articulated in favor of the probability-weighted approach as the means of estimation for situations of measurement uncertainty. Though the probability-weighted approach may be inherently subjective due to its construction potentially being based on hard to verify inputs, there is a higher likelihood of rigor due to the fact that it enforces the consideration and documentation of multiple scenarios and probabilities to a larger extent than the alternative "most likely amount" approach.
- As highlighted in Part I of our response, we believe that additional disclosures that explicitly require
 disclosures related to variable consideration and the use of the reasonably assured threshold should
 be provided.



Time Value (Step #3):

Incorporation of Time Value is Appropriate:

Several Refinements and Disclosure Improvements Necessary

We strongly support the principles of incorporating the time value of money adjustment as it is important to reflect the impacts of the effective financing arrangements in the financial statements.

The ED primarily addresses the time value of performance obligations satisfied at a point in time. There is a need to define and strengthen principles for recognizing the time value component of performance obligations that are satisfied over time. These types of performance obligations will be characterized by their satisfaction occurring over multiple time periods. It is possible that the receipt of consideration could be occurring over multiple time periods in a manner that results in multiple time value related components. The final standard should also address the time value of performance obligations that are satisfied over time.

Further, we believe that the selection of a discount rate is an unresolved cross-cutting issue which the Boards should address across key projects under development. The Revised ED should be amended to provide disclosure of discount rates and to address several presentation refinements. These suggestions are more fully described in the **Appendix**.

Substantial Subjectivity in Various Aspects of Allocating Transaction Price Concerns Investors (Step #4)

We believe the Revised ED provides a smorgasbord of alternatives for preparers to allocate transaction price without there being sufficient disclosures to enable investors to evaluate the quality of the revenue recognition principles. We reiterate our earlier articulated concerns about the subjectivity and auditability of some of the inputs and methods that are used to allocate transaction price. We believe that increased subjectivity and earnings management (e.g. front loading of revenues) will likely result from increased use of estimated selling prices, based on internal estimates, as allowed by the proposed guidance. In general, we are concerned by the lack of the reliability of estimated selling prices for new products or components of products where there is little or no correlation between costs and sales prices when such products are not sold separately. We contend that it is very difficult to estimate selling prices until substantial stand-alone sales are achieved. We are also concerned that these estimated selling prices will be difficult to audit.

In addition, the Revised ED has allowed increased flexibility to use residual approaches for estimating selling prices for highly risky performance obligations and this will exacerbate the subjectivity concerns. Although the guidance states that entities should maximize the use of observable evidence, the failure to provide a hierarchy as we have recommended, minimizes the likelihood that preparers shall sufficiently prioritize observable evidence. As is the case with fair value measurement, a hierarchy for inputs helps to operationalize the prioritization of observable evidence.

We are also concerned by the additional subjectivity in transaction price allocation that could arise due to the: a) application of residual methods to determine estimated selling price; and b) option to allow allocation of discounts to separate distinct performance obligations.

Our concern about the increased subjectivity in revenue recognition and measurement during transaction price allocation is compounded by the exclusion from scope of the recognition of losses from onerous performance obligations that are satisfied at a point in time. Onerous performance obligations could arise within multiple arrangement contracts and the recognition of related losses could potentially help users to identify where the transaction price allocation has been inappropriate.



Finally, as highlighted in our letter of 17 May 2012, we recommend specific and robust disclosures for estimated selling price and allocation methods. The disclosure requirements in the Revised ED are highly generic and are likely to produce only boilerplate disclosures.

Criteria for Performance Obligations Satisfied Over Time Needs Clarification (Step #5)

In our response to the ED, we articulated a widely shared concern about the robustness of the requirements of determining transfer of control for service industries and generally where performance obligations are satisfied over time. We acknowledge that the re-exposure has provided additional guidance related to performance obligations that are satisfied over time including those that relate to service industries. However, there remain shortcomings that need to be addressed. The criteria for performance obligations satisfied over time need further clarification. A number of new concepts and criteria including 'no assets created with an alternative use' have been introduced through Paragraphs 35 and 36. As we understand it, these criteria are meant to help operationalize the transfer of control notion for performance obligations that are satisfied over time. However, there are also multiple and potentially confusing issues that readers will have to work very hard to decipher when going through this proposed guidance. Our concerns relate to the following issues for performance obligations that are satisfied over time:

- Core principle of transfer of control definition still needs tightening;
- The lack of distinctive guidance for goods versus services;
- Criteria of performance obligations satisfied over time needs further clarification and enhancement;
- Alternative use of asset as a criterion for determining performance obligations satisfied over time, may distort revenue recognition; and
- Low eligibility threshold for applying input methods when measuring progress towards completion
 of performance obligations that are satisfied over time.

We also have concerns regarding the guidance on bill and hold transactions as this omits fixed delivery schedule. This concern relates to point in time performance obligations. Finally, as highlighted in our letter of 17 May 2012, we recommend specific and robust disclosures for performance obligations that are satisfied over time or at a point in time. We elaborate on all the aforementioned points more fully in the **Appendix**.

Exceptions to Onerous Obligations are Unjustified

We support the performance obligation being the unit of account when it comes to recognizing onerous contracts. Such treatment allows a cohesive approach across the different components of the revenue recognition model. Admittedly, some preparers may argue that their economically relevant unit of analysis is the contract. They could also argue that contracts may be profitable, though individual performance obligations are not. It is conceptually inconsistent, however, to the entirety of the revenue recognition model set forth in the Revised ED to allow revenues or gain potential to be based on performance obligation as the unit of account and then to revert to a more aggregated unit of analysis when communicating the loss potential. Users should still be able to discern contract level profitability, if there is a comprehensive disclosure of the associated profitable performance obligations within contracts.

We are also opposed to exemptions granted from recognition of losses for onerous performance obligations. The exemptions are granted when performance obligations are satisfied at a point in time and when performance obligations satisfied over time are less than one year. These exemptions, which have been granted as practical expedients, are likely to increases opportunities for earnings management.



Transfer of Non-Financial Assets

We agree with the proposal that for the transfer of a non-financial asset that is not an output of an entity's ordinary activities, the related standards should be amended appropriately. This proposal will contribute to conceptual consistency across related standards.

Clarification of Impact of Cost Guidance Required

Accounting for the recognition and deferral of costs is dispersed and ad-hoc under existing US GAAP and IFRS. Further, the decisions made with respect to the deferral of costs under the four key projects under development (revenue recognition, leases, insurance and financial instruments) are not necessarily moving in lock-step. Accordingly, it is challenging – without a detailed update across projects – to ascertain consistency as it relates to the treatment of deferred costs and their amortization. Conceptual consistency should be a driver of the Boards' actions. Simultaneously, there is limited discussion in current financial statements regarding the nature of costs, their deferrals and the amortization (and impairment) of such deferrals.

We have several concerns related to the accounting for costs as set forth in the Revised ED. They are summarized below and discussed in detail at the **Appendix**:

- There is a need for greater clarity on the Revised ED's impact on the deferral of costs.
- Cost deferral is anchored to the contract as the unit of account, whereas revenue is anchored to the performance obligation as the unit of account. The inconsistent treatment in costs and revenues will increase managerial discretion to influence gross margins.
- We agree with Tom Linsmeier, as expressed in his alternative view in Paragraph AV 9(a), that there is a lack of a robust approach to the extension of the amortization period for deferred costs to a period beyond the original contract period. This approach is fraught with earnings management potential.
- There are differences between US GAAP and IFRS as to whether impairment reversals are allowed. We recommend the prohibition of impairment reversals as required under US GAAP. There is no conceptual justification for a difference in treatment of such reversals.
- There is a need for more robust guidance on 'amortization and impairment of deferred costs'.
- Additional costs disclosures are required to prevent against earnings management.

CLOSING REMARKS

If you, other board members or your staff have questions or seek further elaboration of our views, please contact either Vincent T. Papa, PhD, CFA, by phone at +44.207.531.0763, or by e-mail at vincent.papa@cfainstitute.org, or Sandra J. Peters, CPA, CFA, by phone at +1.212.754.8350, or by e-mail at sandra.peters@cfainstitute.org.

Sincerely,

/s/Sandra J. Peters
Sandra J. Peters, CPA, CFA
Head, Financial Reporting Policy
Standards and Financial Markets Integrity Division

/s/ Gerald I. White Gerald I. White, CFA Chair Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council