

May 17, 2012

Mr. Hans Hoogervorst
Chair
International Accounting Standards Board
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United Kingdom

Ms. Leslie Seidman
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Financial Accounting Standards Board
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Re: Comment Letter on Revision of Exposure Draft on Revenue from Contracts with Customers – Part I (Disclosures, Presentation & Transition)

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 (“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.

¹ 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.

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.

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

**OUR RESPONSE IS DIVIDED INTO TWO PARTS
TO EMPHASIZE THE IMPORTANCE OF
DISCLOSURE, PRESENTATION & TRANSITION MATTERS**

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 & Measurement matters associated with the five steps in the revenue recognition model proposed by the Boards.

We are addressing disclosure, presentation, and transition issues separately as we don't believe their importance to investors is garnering sufficient attention.

Rather than recognizing that disclosures, presentation and transition matters are the means by which the change in revenue accounting is communicated to investors, preparers and auditors seek to short-cut this vitally important step. The desire to reduce disclosures and to depart from a fully retrospective transition approach fails to consider that this information is highly relevant to investors.

Many forget that financial reporting is a communication device and that presentation, disclosures, and transition effects are the key elements of this communication. As such, these matters should not be an "after-thought" for the Boards or a decision made solely to mitigate the cost of conversion to a new revenue recognition standard. These aspects of the Revised ED are essential elements of investor communication regarding what virtually all investors see as the most important financial statement line item – revenue.

Investor views should be paramount as the Boards re-deliberate these presentation, disclosure, and transition matters given that they ultimately bear the cost of these communications – either through the actual costs to prepare them or worse, by suffering from the uncertainty associated with the impacts not being clearly and transparently communicated.

In the sections below we provide an overview of our views regarding disclosure, presentation and transition matters. Our detailed comments may be found in [Appendix I](#).

OVERALL OBSERVATIONS

Disclosures

In our detailed analysis of the Revised ED's disclosures in [Appendix I](#), we highlight member surveys which emphasize the importance of revenue recognition disclosures and we summarize findings from our review of the revenue disclosures of the 30 companies comprising the Dow Jones Industrial Average. The disclosure review and member feedback demonstrate the poor current state of revenue disclosures and the importance of revenue to investors and other users of the financial statements. Both suggest that substantial disclosure improvements are necessary as current revenue disclosures are generally boilerplate and convey little information specific to the firm. As we articulate below, investor needs and the facts versus the myths of the existing disclosures – as well as the quality, time intensity and cost of the proposed new disclosures – need to be more thoroughly evaluated.

1) Overarching Revenue Disclosure Observations –

- a. The Premise That The ED Would Result in a Significant Increase in Disclosures Across All Companies is False – There is a fundamentally flawed yet widely held premise that the proposed disclosure requirements in the Original ED and the Revised ED will be universally burdensome for all companies. This premise is flawed because the disclosures will only have an impact where there are multiple-element contract arrangements or long-term contracts with significant estimates. For a significant portion of the preparer population, a majority of the disclosures will not be required.
- b. Disclosures Are Not Excessive Given Importance of Revenue To Investment Decision-making – Revenue disclosures are necessary given that revenue is pervasive for all industries. Further, the long history of earnings management and need for restatement in this area demonstrates that companies should be held to a high standard in making these disclosures. We believe it is disingenuous for preparers to be highly vocal in seeking to minimize the required disclosures given the importance of revenue and the low quality of the current disclosures.
- c. Revenue Disclosure Requirements Should Be Considered In the Context of Other Disclosure Requirements – It seems ironic and counterintuitive that preparers are requesting the Boards seek to rationalize disclosures for this highly relevant financial statement element. There are presently greater and more detailed disclosure requirements with respect to pensions, financial instruments, taxes, and many other financial statement elements than are required for revenue, which drives the entirety of the business. The Boards should consider why they believe fewer disclosures are required for revenue than for these financial statements elements when reaching their decision with respect to rationalizing or enhancing disclosures.
- d. Investors Are Skeptical When Companies Say They Can't Produce the Revenue Disclosures – Overall, we find it troublesome that preparers suggest gathering such information will be burdensome or impossible. Investors would question management's ability to manage the business, and provide cash flow projections or earnings guidance if they cannot provide such information. The disclosures simply call for communication of the judgments and estimates management has made in the recognition and measurement of revenue, the determination of the nature of the performance obligations management has committed to perform and an explanation of the cash versus revenue recognition pattern associated with those commitments.
- e. Disaggregation and Rollforwards: If They Aren't Important to Revenue Disclosures When Will They Ever Be? – Many of the complaints with respect to the revenue disclosures focus on the requirement to disaggregate revenue disclosures in the notes and to prepare rollforwards/reconciliations of contract assets and liabilities. Disaggregation and rollforwards were key elements of the Financial Statement Presentation Project, which the Boards deferred. We believe if the Boards back away from these key elements of disclosure and presentation at this time in such a key project they will be making a broader statement to investors that they do not believe these financial reporting elements are critical, despite their importance to investors.

- f. *The IASB and FASB Need to Evaluate Disclosure Requirements Against Investor Needs* – The Boards and IASB and FASB staff need to make a paradigm shift in their consideration of the revenue recognition disclosures. The Board’s stated mission is providing decision-useful information to investors. If disclosures provide decision-useful information and investors are willing to pay for them, then the burden should be on preparers, to justify their inability to provide the information. Given the significant enhancement in revenue recognition disclosures required, we believe the Board is asking the wrong question in the Revised ED. Asking investors which of the currently specified disclosure proposals should be either eliminated or prioritized – so as to assuage preparer desire for a minimal compliance burden – is not consistent with serving the needs of investors. Rather, the Boards should be evaluating whether the disclosures are necessary to explain to investors the estimates and assumptions employed in the revenue recognition process and to communicate the disconnect between the timing of revenue recognition and cash collection (i.e. the cash conversion cycle). If reporting is to be useful it should be anchored to investor needs.
- g. *Disclosures Require Greater Specificity & Enhancement, Not Rationalization* – Though we support the principle of requiring enhanced disclosures, the current requirements – especially post their “adjustment” from the Original ED to the Revised ED – are either too broad or they are not sufficiently comprehensive to provide a full reflection of all revenue related flows. We fear that the broad specification of requirements may lead to boilerplate and uninformative disclosures.
- h. *Investors Need to See The Connection Between Revenue and Cash* – Revenue reported under the Revised ED would contain both inherent economic and accounting uncertainty and only a robust disclosure regime that complements recognition and measurement, can help investors to assess the association between reported revenues and related cash flows from these revenues. That association is critical to enterprise valuation. We believe that reporting cash flows by type of revenue in a direct method statement of cash flows would allow investors to understand the linkage between revenue recognition patterns and cash flow collections. Enterprise valuation requires confirmation that revenue recognized is ultimately converted to cash, and knowledge regarding the timing of the conversion. Our historical advocacy for the direct cash flow method stems from the importance to investors of this need to connect revenue and cash measurements.
- i. *Investors Likely to Be Disappointed By Actual Disclosures Provided: An Expectations Gap Exists* – We believe that many investors and other stakeholders may not understand the accounting parlance being used to explain the balances subject to disclosure (e.g. contract assets, contract liabilities and performance obligations). Because of this, there is not a complete understanding of the nature of the balances created by the standard. Investors do not understand that contract assets are not accounts receivable, deferred revenue is one type of contract liabilities and performance obligations are not “backlogs.” As a result, there is a misperception regarding the disclosures that will actually be provided. For example, some investors mistakenly believe a reconciliation of accounts receivable will be provided. We see an expectations gap between what investors believe they will receive as disclosures and what will ultimately be provided.

- 2) General Recommendations for Improving Revenue Disclosures – As we consider the disclosures we have several general recommendations for the Boards:
 - a. Better Articulate Balances Created by Standard – We believe that stakeholders are not sufficiently clear regarding the balances created, the terms used in the standard and other common terminology (e.g. accounts receivable, contract assets, contract liabilities, performance obligations and backlogs). We believe the Boards should clarify these concepts so there is a full understanding of the effects of the standard and the disclosures being made.
 - b. Emphasize Tabular Presentation – The final standard should include a requirement (not an option) to provide reconciliations/roll-forwards in a tabular format. Similarly, other disclosures which can be presented in a tabular format should be required to be presented in such a manner.
 - c. Disclosures Should Not Be A Substitute For Appropriate Presentation – Strong preference is accorded by investors to the presentation of appropriate revenue related items on balance sheet, income statement and cash flow presentation rather than in footnotes.
 - d. Disclosures Should Inform on Unit of Account (Performance Obligation) – The performance obligation is the unit of account for revenue determination under the Revised ED and revenue disclosures should, at a minimum, aim to inform on judgments related to performance obligations.
- 3) Investors Require Complete Interim and Annual Revenue Disclosures – All one needs to do is listen to business news channels during earnings season and it is readily apparent that interim disclosures about revenues can drive share prices. It is therefore obvious that the disclosures regarding disaggregation of revenue, as an example, are important at interim reporting dates and it is puzzling that the Boards are posing the question regarding the need to make interim revenue disclosures equivalent to annual revenue disclosures. Our survey results support this conclusion. We expand on the importance of interim disclosures in [Appendix I](#).
- 4) Evaluation of Proposed Disclosure Requirements and Recommendations – We have evaluated the various disclosure proposals in the Revised ED. In our comment letter to the Original ED, we identified several omissions and shortcomings with the proposed disclosures. Other than the inclusion of disclosures related to deferred costs, the Revised ED does not address most of the issues that we highlighted. A summary of our findings and recommendations related to the Revised ED are contained below:
 - a. Disaggregation –
 - i. Disaggregation of Revenue on Income Statement Is Preferable to Footnote Disclosures Due to Enhanced Timing & Increased Prominence of Income Statement Presentation – We support the disaggregation of revenues, with a strong preference that this disaggregation be done on the face of the income statement because it will ensure that the information is accorded its appropriate prominence and the information will be delivered at the time of the earnings release – rather than weeks later in the notes to the financials. This is especially true under IFRS rather than U.S. GAAP as SEC revenue disclosures require a disaggregation of at least goods and services on the face of the income statement at the date of the release.
 - ii. SEC Regulation S-X Requirement to Disaggregate Revenue: Goods versus Services – We would note that SEC Regulation S-X Rule 5-03 requires disaggregation of revenue by net sales of tangible products (gross less discounts, returns, and allowances) and revenue from services. However, we would observe that the Revised ED does not include a definition of “goods” or “services.” We believe it is important to define “goods” vs. “services” under U.S. GAAP and IFRS so that there is a consistent application of that distinction. Without such definitions we believe there will be a lack of comparability around the world.
 - iii. Disaggregation Criteria Lack Linkage to Revenue Recognition Model, SEC Guidance and Segments – We are concerned that there is a disconnect between how decisions are made under the steps of the revenue recognition model and how revenue will be communicated in the financial statements. The disaggregation of revenue disclosure requirement is not

- necessarily consistent with the decisions made under the revenue recognition model in the Revised ED. Further, there is no requirement to disaggregate revenues by goods and services, as noted above, nor is there any requirement to link the disaggregation decisions to the segment reporting disclosures. We are concerned that there will be a disconnect in the communication of the disaggregation of revenue, the decisions made in the model and the other financial reporting requirements as it relates to revenue. Before finalizing the Revised ED, we believe the Boards should consider a requirement which facilitates the linkage of these different decisions.
- iv. *Disaggregation is Fundamental to Financial Statement Presentation* – We are concerned that the Boards are being pressured to eliminate the greater disaggregation requirements of the Revised ED. We would note that the concept of disaggregation is central to effective financial analysis and investors have been requesting better disaggregation for decades. If the Boards abandon greater disaggregation for revenue – arguably the most important number on the income statement – they are making a broader statement with respect to the importance they place on the concept of disaggregation. We believe investors will take such a decision as a broader decision to abandon the central tenets of the Financial Statement Presentation Project, which is premised on the need for more disaggregation.
- b. *Rollforward (Reconciliation) of Contract Balances* – We are fully supportive of the inclusion of a rollforward of contract assets and liabilities. Rollforwards communicate significant information with respect to the nature of the balances and their activity, which can be highly informative in understanding the valuation of balance sheet accounts and their impact on the income statement. More important, they separate cash from non-cash and operating from non-operating elements. As we articulate above, rollforwards are a central tenet of the Financial Statement Presentation Project and the Boards should resist pressure to eliminate these rollforwards – and greater disaggregation – as doing so sends a message to the investor community regarding the Boards' views on the importance of these essential financial statement presentation tenets.

We believe there are misunderstandings and miscommunications amongst all key stakeholders (investors, preparers, and auditors) regarding the scope and content of these rollforwards. Greater discussion and clarity is required to appropriately communicate to investors what will be provided and to temper the assertions of preparers. Below we articulate our concerns with respect to the rollforwards and our recommended enhancements.

Concerns Regarding Rollforwards

Our principal concerns with respect to the rollforwards are as follows:

- i. *Lack of Clarity on Balances Within Scope of Rollforward Requirement* – The lack of clarity regarding the difference between a contract asset and an accounts receivable has left many investors with the mistaken perception that this disclosure requirement will result in a rollforward of accounts receivable. It will not. Further, the requirement calls for an aggregated and net rollforward of contract asset and liability balances. It is our view that the rollforward will not appear in many financial statements as only a limited number will have significant contract asset or contract liability balances. If it does appear, it will be an aggregate of all contract assets and liabilities which are then netted – the result being information with little meaning or decision-useful value.
- ii. *Aggregation & Net Presentation of Rollforwards Limits Decision-Usefulness* – The Proposed Update allows the preparation of the reconciliation on an aggregate (all contract assets and all contract liabilities) and net (contract assets netted against contract liabilities) basis. We understand that this net presentation would be allowed because preparers have expressed concerns regarding situations where a contract may move from a contract liability to a contract

asset position (or vice versa). Our issue is that netting the contract asset and contract liability balance is meaningless to users as contracts are either in a contract asset or contract liability position and contract assets and liabilities have no relationship to each other. The notion that the contract asset and contract liability should be netted is based upon a mechanical convenience which has the effect of improperly conveying there is a relationship between the two balances. Similarly, presenting a rollforward of all contract assets and all contract liabilities does not result in decision-useful information as the nature of the balances may be very different. The insight provided by the rollforward is substantially mitigated when many different balances are aggregated and netted. Accordingly, we believe rollforwards should be presented individually and not netted. There is no additional work required by preparers to present this information in this manner as all the information will have to be accumulated by account. In fact, not aggregating or netting will reduce the work required by preparers to accumulate and net the balances.

- iii. Requirement to Reconcile Income Statement Elements of Rollforward to Income Statement is Not Apparent to Most Stakeholders and May Reduce Decision-Usefulness of Rollforwards To Investors – We have reconstructed the reconciliation illustration in Paragraph IE 17 and presented it in [Appendix II](#). Based upon the illustration, there must be reconciliation of satisfied performance obligations in the rollforward to the income statement. However, not all satisfied performance obligations are associated with the contract assets or liabilities being reconciled. Inclusion of items which do not flow through the contract asset and contract liability accounts – besides being incorrect – distorts the usefulness of the reconciliation.

Further, the construction of this reconciliation – while it may be useful in the construction industry – does not seem to acknowledge the accrual nature of many contract asset and liability accounts. Many of such balances are not directly impacted by cash transactions. In such circumstances, the reconciliation is not providing the most meaningful information related to deferred revenue. We describe the more meaningful information below and in the discussion of contract liabilities.

Recommended Enhancements

Our principal recommendations with respect to the rollforwards/reconciliations are as follows:

- i. Accounts Receivable Rollforward Should Be Separately Presented and Cash Sales Separately Disclosed – The decision-usefulness of the rollforward is increased exponentially by the separate reconciliation of accounts receivable balances. Rather, than included amounts transferred to accounts receivable in the contract asset/liability rollforward a separate rollforward of accounts receivable should be added.
- ii. Rollforward of Contract Assets and Contract Liabilities Should Be Done Separately – Because contracts are either in an asset or liability position, and, as described above, it is misleading to communicate that such balances are related, we believe the reconciliation of contract asset and contract liabilities should be done separately. The fact that a contract moves from a contract asset or contract liability should not result in the communication of misleading net information to investors. The contract balances will have to be rolled forward separately so the requirement to present separately is no additional work for preparers.
- iii. Rollforward Requirement Missing Key Elements – We find the rollforward example omits key elements of the rollforward such as the impacts of foreign currency changes, acquisitions and divestitures, and the time value of money. These should be presented as separate and distinct elements of the rollforward as they are economically different from operating changes.
- iv. Contract Assets: Disclosure of Contingent Performance Necessary – There is need for disclosure regarding the nature of the contingent performance upon which the contract asset is

based, when it will occur and when the contract asset will be converted to an accounts receivable. Said differently, investors want to know the period during which the contract asset will convert to a receivable and then to cash. Further, investors need to know when a contract asset is reduced and revenue reversed because the secondary performance obligation was not satisfied.

- v. Contract Liabilities: Disclosure of Revenue Recognition Pattern Necessary – The principal issue for investors with respect to contract liabilities is when are the performance obligations expected to be satisfied and when are contract liabilities expected to become revenue. As we describe more fully below, any performance obligations included within contract liabilities that relate to a contract with an original duration of greater than one year, will be included in the performance obligation disclosures. However, the extent of the overlap will not be disclosed and therefore eliminates the decision-usefulness of the information. We believe disclosures associated with the pattern of revenue recognition are the most valuable information associated with such balances and have proposed additional disclosures below.
- c. Performance Obligations –
 - i. The Problem with the Proposed Performance Obligation Disclosures – We believe the disclosure requirements with respect to performance obligations in Paragraphs 118 through 121 will not result in the most decision-useful information to investors and could potentially result in confusing, at a minimum, and potentially misleading information for investors. Our view stems from several key factors:
 - 1) The lack of disclosures of all performance obligations – rather than simply performance obligations with an initial duration of greater than one year.
 - 2) The inability of investors to discern the overlap – or lack of overlap – between contractual liabilities and performance obligations.
 - 3) The lack of disclosures regarding the relationship between performance obligations to be satisfied and contract assets for which revenue has already been recognized but is dependent upon the satisfaction of future performance obligations to become collectible.
 - 4) The lack of distinction between performance obligations as defined under the standard and “backlogs” – specifically the inability investors will have to discern the difference between these disclosures and backlog disclosures required by SEC Regulation S-K Item 101(c) (viii).
 - 5) The lack of a requirement to make all of the aforementioned disclosures (performance obligations, contractual liabilities, backlogs) in a cohesive quantitative manner.
 - 6) The lack of quantitative disclosure of the expected realization (i.e. maturity analysis) of revenue from such performance obligations, contractual liabilities, and backlogs.

Without clearer distinction between contract liabilities, performance obligations and backlogs as well as the relationship between future performance obligations and existing contract assets it is impossible to utilize the information in a decision-useful manner. Without insight into the completeness of the disclosures and their relationship to each other the information provided is not useful to investors in projecting future revenue trends or understanding future cash flow prospects.

The figure in [Appendix I](#) diagrammatically illustrates the omission, overlap and confusion which will be created by the proposed disclosures. We also describe there why these disclosures are important to investors and why they should be enhanced rather than removed.

- ii. Proposed Enhancements to Performance Obligation, Contractual Liability & Backlog Disclosures –
- 1) Definitional Enhancements – As we note above, clearer definitions and demarcations of performance obligations, contractual liabilities and backlogs are necessary as each are meaningful predictors of future revenue.
 - 2) Complete & Cohesive Disclosures of Performance Obligations, Contract Liabilities & Backlogs – Hand-in-hand with clearer definitions should come complete, cohesive and quantitative disclosures of all performance obligations, contractual liabilities and backlogs. As we believe it provides an incomplete picture, we do not agree with the disclosures related to the presentation of a maturity analysis of performance obligations with durations of more than one year. Without clearer distinctions and quantification of the amounts, the information is not decision-useful.
 - 3) Maturity Analysis of Performance Obligations, Contract Liabilities & Backlogs – In addition to a quantitative and cohesive disclosure of performance obligations, contractual liabilities and backlogs, we also need disclosure of the expected “run-off” or “maturity” of each of these items in order for the information to be predictive and decision-useful. Additionally, the extent to which current period revenue represents amounts included in prior period backlogs would also be useful to investors.
 - 4) Performance Obligations Related to Contract Assets – As analysts are interested in when contract assets will convert to cash, it is important for performance obligations that are related to contract assets to be separately identified and their timing to be separately disclosed. Delay in performance of such obligations will result in an extension of the cash conversion cycle and failure to perform the obligation will result in a reversal of revenue.
 - 5) Unsigned Contracts – If an entity has substantial contracts that are deferred for signature – or performance – until the inception of the next accounting period, we believe disclosures of such information would be useful to investors. This is simply another form of backlog.
- iii. Enhancement to Onerous Performance Obligations Also Required – Further to the disclosures already required for onerous contracts in Paragraphs 122 and 123, it would be useful if there were disclosures of:
- a) contracts near to becoming onerous (i.e. a “watch list”); and
 - b) the nature and amounts of contracts that are onerous but exempt from loss recognition requirements.

We also believe it is important for preparers to analyze the root causes for performance obligations becoming onerous and evaluate whether the onerous nature of the obligations results from a misallocation of revenues at that inception of the contract.

- d. Revenue Recognition Steps & Judgments –
- i. Quantitative & Qualitative Information is Necessary – We believe it is important that the disclosures regarding such judgments and estimates be made in sufficient detail and with sufficient specificity (i.e. not boilerplate disclosures) that investors can determine how such decisions correlate with the revenue recognition measurements included in the financial statements. This would include more than just a qualitative description of the decisions and judgments. Such qualitative decisions should be connected with quantitative measurements or revenue included within the financial statements.
 - ii. Step #1 (Contract Definition) and Step #2 (Identifying Separate Performance Obligations): No Disclosures Provided To Investors – The Revised ED provides no disclosures related to Step #1 or Step #2 of the revenue recognition model. These steps include entity-specific judgments made with respect to contract definitions including modification and combination decisions and judgements regarding whether performance obligations are distinct. We believe disclosures regarding such judgements should be required.
 - iii. Step #3 (Determine Transaction Price) –
 - 1) Variable Consideration and Reasonably Assured Threshold: Significant Enhancements to Disclosures Required – Paragraph 127 with respect to disclosures about judgments made in determining the transaction price are highly generic. The disclosure guidance in this paragraph or elsewhere in the Revised ED makes no mention of the need to make disclosures associated with variable or uncertain consideration. Still further, the “reasonably assured” recognition criteria has been added to the Revised ED without the addition of any disclosure requirements. These highly variable and subjective measurement and recognition criteria cannot be added without disclosure to investors.

It is important to understand the specifics of variable or uncertain consideration and the application of the reasonably assured threshold in the context of revenue measurement and recognition as these are the areas where the line between measurement and recognition become blurred and especially challenging. They are highly subjective and they result in some of the most significant abuses, estimation problems and causes of restatement (e.g. Groupon). We have suggested additional disclosures at [Appendix I](#).

- 2) Credit Risk: Several Additional Disclosure Elements Necessary –
 - Disaggregation of Credit Risk – In the Presentation section we set forth our support for the adjacent presentation of the credit risk adjustment. However, we recognize that this adjacent amount will commingle a number of items that investors would like separated. For example investors would like to make a distinction between the following: a) current versus prior period uncollectible amounts; b) expected versus realized losses; and c) adjustments for differences between initial recognition amounts for accounts receivable and revenue. There should be a disclosure in the notes related to this adjacent income statement line which disaggregates these amounts.

Expected vs. Ultimate Losses – We believe the final standard should include separate disclosures of initial expectations of credit losses as well as subsequent changes in expectations. This should include cumulative expected versus actual uncollectible amounts.

Rollforward – Further, we believe a roll-forward of credit losses (allowances) should be provided within the notes to the financial statements. Such roll-forward should include beginning and ending allowances for credit losses on previously recognized revenue amounts, estimates of expected credit losses on new revenue, revisions to expectations of credit losses, and adjustments related to foreign currency, business combinations.

- 3) *Time Value of Money – Discount Rate Disclosures Required* – The Revised ED does not require disclosure of the discount rate. In addition, there should be clarification regarding whose discount rate (i.e. seller vs. customer) should be, and has been, applied. The basis of discount rate determination (e.g. seller vs. customer) – along with the discount rate – should be included in the disclosure requirements.
 - 4) *Changes in Transaction Price* – The ED does not include provisions for disclosures regarding changes in transaction price. While revenue from allocating changes in transaction price to performance obligations satisfied in previous reporting periods is included in the contract asset or liability roll-forward, there are no disclosures required regarding total changes in transaction price. We believe total changes in transaction price should be disclosed.
- iii. *Step #4 (Allocate Transaction Price): Need Specific and Robust Disclosure Requirements for Estimated Selling Prices & Allocation Methods* – As we described in our comment letter to the Original ED, the disclosure requirements provide generic guidance regarding the disclosure of methods, inputs and assumptions used to estimate stand-alone selling prices. Despite our calls for improved disclosures in our comment letter on the Original ED, nothing was done to improve the disclosures in this regard. Despite the enormous importance of these judgments, there is but one line in the Revised ED with respect to disclosures of the methods used to determine estimated selling prices. This is Paragraph 127(d). There is nothing which requires disclosure of the use of market vs. estimated selling prices in Paragraph 72 or 73, the allocation method chosen in Paragraph 73, the discount method chosen in Paragraph 74 or Paragraph 75 or the existence of contingent amounts in Paragraph 76.

We recommend more robust disclosures regarding the basis of determining the estimated selling price. As we highlighted through previous commentary, our experience in the United States has been that disclosures related to the use of estimated selling price per EITF 08-1, *Revenue Arrangements with Multiple Deliverables*, and EITF 09-3, *Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements* – two standards that mirror the proposals in this ED – are usually uninformative.

We believe more robust disclosures are required regarding the basis of determination of estimated selling price. There should also be disclosure of the magnitude of distinct performance obligations based on the proposed hierarchy of estimated selling prices as we outline in our separate letter on Recognition & Measurement issues.

- iv. Step #5 (Satisfaction of Performance Obligations): Disclosure Enhancements Required –
- a. No Disclosures Regarding How Point in Time vs. Over Time Judgment Made – The satisfaction of performance obligations at a point in time or over time is premised on transfer of control. However, there are no explicit requirements for disclosures regarding the criteria used to determine whether a performance obligation has occurred at a point in time or over time. The disclosures required by Paragraphs 125 and 126 are provided without requiring disclosure regarding how it was determined which (i.e. overtime or point in time) would apply. For example, was a judgment made that a good or service transfers over time because it had no alternative use or because the customer maintains control of the asset? Was the revenue recognized because there was a right to payment? Further, the requirements of Paragraphs 125 and 126 are highly generic given the importance – and newly added complexity – of this step in the Revised ED. It is essential that users have disclosures regarding the judgments associated with the determination of when and how transfer of control to customers occurs.
 - b. Recognition Process & Disaggregation Disclosures Lack Consistency – The Revised ED requires separation of distinct performance obligations yet no disclosure of revenue by these types of distinct performance obligations. It requires recognition of revenue by whether the performance obligation is satisfied over time or at a point in time, but provides no requirement that revenue recognized by either method be disaggregated and disclosed by this method. Additionally, we expect that disclosures will be made by goods versus services (as required in the U.S. by SEC rules), yet there will be no connection of the goods and services disclosures to the performance obligation or whether it will be satisfied over time or at a point in time. Overall, there is substantial effort being put forth in executing the keys steps to the model proposed in the Revised ED but no transparency to investors with respect to how those judgments and estimates result in the revenue recognized and displayed in the financial statements.

- d. *Cost Disclosures: Additional Cost Disclosures Required To Prevent Earnings Management* – We are pleased to see the addition of some disclosures (Paragraph 128 & 129) related to the deferral of costs in the Revised ED as the Original ED did not include any cost related disclosures. However, these cost deferrals and amortization methods are highly subjective and laden with earnings management potential. We believe key disclosures related to cost deferral, amortization and impairment are missing from the Revised ED. Cost deferral and amortization have the effect of separating the cash and expense recognition patterns in the financial statements. Accordingly, sufficient disclosures are necessary for investors and users to understand the disparity of the cash vs. expense recognition trends. Disclosures should be robust enough to deter any earnings management behaviour and make any unusual trends readily apparent to investors. Included at [Appendix I](#), and summarized below, are several important enhancements required:
- i. Preparers should disclose the nature of costs deferred during the period and the basis for capitalizing such costs. Currently no such requirement exists.
 - ii. Roll-forwards should disaggregate the impacts of foreign currency fluctuations and business combinations.
 - iii. The method by which costs have been allocated to various performance obligations and, accordingly, the amortization pattern of recognizing such costs as expense should be disclosed.
 - iv. The extent to which amortization is to occur over future renewal periods or over periods for which contracts are not yet in-force should be disclosed to investors.
 - v. There are no disclosures required to communicate the significant change in the transfer of goods and services, which may alter the amortization pattern. A disclosure of this nature must be added.
 - vi. Impairment reversals should be disclosed separate from impairments and the basis for determining the amount and timing of such reversals should be included in the financial statements.
 - vii. The expected run-off of deferred costs should be disclosed.

Presentation

Review of Paragraphs 104 through 108 of the Revised ED would suggest that all the presentation issues addressed by the Revised ED are balance sheet related. These paragraphs of the Revised ED address none of the income statement or cash flow presentation issues arising from the proposed standard. Some issues are addressed elsewhere in the Revised ED (e.g. collectability and time value) but others such as the classification of “revenue adjustments” on the income statement, as we describe more fully below, or the classification of time value elements (e.g. financing or operating) on the statement of cash flows are not addressed. Before finalizing the Revised ED, we urge the Boards to cohesively review their presentation decisions. Below are several matters the Boards should consider:

- 1) *Disaggregation of Revenue on Income Statement Is Preferable* – We support greater disaggregation of revenues. That said, we believe the disaggregation should appear on the face of the income statement rather than in the notes to the financial statements to provide greater prominence and timeliness to the disclosures. See a more complete discussion above under disclosures in [Appendix I](#).
- 2) *Income Statement Presentation of Gross Revenue and Credit Risk Adjustment is Appropriate* – We are strongly supportive of the proposed adjacent presentation of credit risk as it increases the information content related to underlying gross revenue and credit impairments related to revenue. We support this “gross revenue” presentation as we do not believe investors are aware of the current practice of reducing revenue for amounts where collectability is not reasonably assured nor are they provided with the amount of these reductions. Gross presentation of revenue with adjacent presentation of credit risk has the effect of increasing transparency and reducing earnings management opportunities. We also support the presentation of subsequent updates to credit risk measurement through the same line. We do, however, have suggested improvements in disclosures that we believe are necessary to support this presentation and provide an understanding of the initial versus ultimate expectations of credit losses – such an understanding is important to the assessment of earnings quality.

As noted above, and in our discussion of Step# 3 in our letter on Recognition and Measurement issues associated with the Revised ED, we don’t believe there is a comprehensive understanding of existing practice with respect to the reduction of revenue for amounts for which collectability is not reasonably assured. Further, we do not believe there is an appreciation of the theoretical difference in approach proposed in the Original ED and how it differs from the current guidance or how it has evolved into the proposals in the Revised ED.

- 3) *Presentation of Time Value Needs Several Refinements to Be Cohesive* – The Revised ED proposals would adequately reflect the effects on the income statement by separately reporting interest expense or interest income. In similar fashion, we would propose the disaggregation of the contract asset (liability) portions to reflect the interest payable (receivable) and to have the interest reflected separately in the financing section of the cash flow statement.

- 4) *Presentation of “Revenue Adjustments” Is Not Sufficiently Transparent to Investors* – We noted in our review of the 30 DJIA companies, that their policy footnotes and disclosures were vague as to the precise presentation, and even more so as to the amounts, of what we would refer to as “revenue adjustments” – despite their significant prevalence. We define “revenue adjustments” to include items such as warranties, incentives, rebates, refunds (in cash and in-kind), options, etc. We do not believe the Revised ED, or the Original ED, makes it readily apparent to investors which of these items are considered separate performance obligations (e.g. warranties which can be purchased separately), which are simply reductions of revenue (e.g. refunds) and which may flow through expense captions on the income statement (e.g. warranties accounted for under IAS 37 or refunds in-kind). Accordingly, their presentation within the income statement is not readily apparent and the related disclosures also lack clarity.

These items have been the source of significant debate, restatements and commentary and interpretation by regulators such as the SEC. Further, their location in the income statement can alter ratios or trends that the company and investors believe are important⁴. Comparability between companies can also be impaired. Consequently, the proper classification of these items should not be overlooked by the Boards. We find, however, very little guidance on the presentation of such items within the Revised ED. Only through discussion of related topics are the presentation issues associated with these “revenue adjustments” touched-upon.

Our view is that the Boards need to undertake a comprehensive consideration of the presentation of these “revenue adjustments” to ensure that the guidance is complete and consistent. If not, interpretative guidance will undoubtedly be required as the treatment of these items are likely to vary in practice.

- 5) *Balance Sheet Presentation: Nature of Balances Created by Standard Are Unclear To Stakeholders and Decrease Accessibility and Understanding of Proposed Standard* – Our discussions with investors, preparers and auditors lead us to believe that stakeholders are not sufficiently clear on: a) the distinction between accounts receivable and contract assets; b) the nature of contract liabilities (e.g. deferred revenue is a contract liability); c) how contract liabilities differ from performance obligations; and d) how performance obligations differ from backlogs.

The confusion regarding the differences between these terms leads to only a partial understanding of the revenue recognition model and contributes to the limited ability of stakeholders to meaningfully evaluate what is included or excluded within some of the disclosure components such as the roll-forwards – as we note above. We recommend that the final standard clarify the distinction and interrelationships among these financial statement elements.

⁴ We note that revenues, gross margins, and operating income are key metrics that affect the valuation of many firms, especially those in the technology field.

Transition & Effective Date

Some want to short-cut the transition approach to reduce preparer costs, but they fail to consider that the transition information is highly relevant to investors as it is the mechanism by which the change in recognition and measurement is communicated to investors. The lack of information creates greater uncertainty, which is ultimately priced by investors (equity values are likely to decrease). Inadequate information also increases the costs to investors of evaluating the effects of the new standard.

Preparers and their auditors fail to consider these costs in their advocacy for less useful transition information. Transition should not be an “after-thought” to the Boards or a decision made to mitigate the cost of conversion to a new revenue recognition standard. Transition information is an essential communication tool to investors and this is transition information relative to what some investors see as the most important financial statement element. Failure to understand an earnings trend because of poor accounting transition is highly detrimental to investors. Investors bear the cost of the transition and preparers and the Boards should be focused on investor priorities when making this decision. Below we outline key matters for the Boards consideration:

- 1) *Investors Need Full Retrospective Application: Optionality Is Unacceptable* – As we articulated in our comment letter on the Original ED, and as we reiterate more fully in [Appendix I](#), investors, as we have found from our surveys, require full retrospective application of the new revenue standard. We believe it would be acceptable to defer the effective date of the standard so as to ensure that comparable information is available for analysis and investment decision-making. It should go without saying that the Boards should prohibit any optionality in transition approach or effective date. This will destroy comparability between organizations – for many years and possibly permanently – and should not even be considered by the Boards.

An entirely prospective method mixes old and new recognition and measurement guidance and creates decision-useless information and because of this is unacceptable. Further, a modified prospective approach provides no historical trends that investors can use to assess performance. Some suggest an approach similar to that followed under the adoption of EITF 08-01 be followed. Our view is that those disclosures were not useful.

- 2) *Cost of Converting to a New Revenue Standard Should Not Be Confused With Cost of Retrospective Adoption* – During a recent roundtable on the Revised ED in Norwalk, it became clear that many are confusing/intermingling the cost of transitioning to a new revenue recognition standard with the cost of preparing retrospective information. Many cite the cost of building new IT systems, reviewing contracts with customers, and determining the follow-on impacts as reasons not to provide retrospective information. We consider each of these costs at [Appendix I](#), as we believe the conversation regarding transition approach (prospective vs. modified prospective vs. retrospective) conflates the “cost of change” and the “cost of retrospective adoption.” Further we believe a deferred effective date has the effect of mitigating the cost by converting what many perceive as wasted efforts/costs in looking backward to a prospective consideration of changes. Moreover, a deferred effective date approach would permit preparers to implement the new standard over time. It also has the benefit of providing them with the ability to analyze the impact of the change and better communicate that impact to investors.

We understand there is a cost of change, but the decision to create a new standard has already been made. We do not believe the costs of retrospective change are being computed properly and we encourage the Boards to be disciplined in their analysis. Finally – to reiterate our early point – investors want

retrospective presentation and, as owners of the company, they pay for that information and it should be provided. The Boards should remember that it is investors who bear the ultimate cost of change.

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 +44.207.330.9521, or by e-mail at vincent.papa@cfainstitute.org, or Sandra J. Peters, CPA, CFA, by phone at +1.212.754.8350, or by e-mail at sandra.peters@cfainstitute.org.

Sincerely,

/s/Sandra J. Peters

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Head, Financial Reporting Policy
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/s/ Gerald I. White

Gerald I. White, CFA
Chair
Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council