CFA Institute

APPENDIX

SPECIFIC COMMENTS AND RESPONSE TO QUESTIONS

The answers to specific questions posed in the Revised ED are embedded within our updated comments and cross-referenced accordingly. Our comments related to Recognition & Measurement are included herein while our comments related to Disclosures, Presentation and Transition are included in Part I of our letter on the Revised ED. Our Recognition & Measurement comments are organized as follows:

- **Step #1** – Identify Contracts with Customers
- **Step #2** – Identify Performance Obligations
- **Step #3** – Determine Transaction Price (Questions #2 and #3)
- **Step #4** – Allocate Transaction Price
- **Step #5** – Satisfy Performance Obligation (Question #1)
- **Onerous Performance Obligations** (Question #4)
- **Transfer of Non-Financial Assets** (Question #6)
- **Cost Recognition**

STEP #1 – IDENTIFY CONTRACTS WITH CUSTOMERS

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. The criteria[1] for contract combination, specified in Paragraphs 16 and 17 considers interrelatedness of contracts based on the following conditions: the timing of contract inception; whether contracts were jointly negotiated as commercial package; and their being price and functional interdependence. The incorporation of performance interdependence (i.e. functional interdependence) into the criteria as we had previously recommended, is particularly appropriate. We also agree with the emphasis on a broader range of factors as a basis of contract combination. Further, as a part of the Original ED, there was an overlap between the criteria used in segmenting contracts (e.g. price interdependence criteria) and the criteria used to identify distinct performance obligations. We agree with the reason provided for dispensing of the segmentation of contracts requirement within the Revised ED namely that the segmentation resulted in duplicative judgments with those made in Step#2, and was, therefore, redundant.

As we understand, 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 is relevant for industries with long-duration and complex contracts. During standard setter outreach, Step #1 has typically come across as a low impact step on the grounds that revenue transactions across many business models do not require elaborate contracts. Yet, for contract intensive industries, 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.

In addition, due to inadequate examples and the absence of field testing alongside a highly abstract description, it is a struggle for users to have a full appreciation of the possible interaction and interdependency between the contract combination or modification judgments and other revenue recognition steps. User interpretation difficulties are compounded by the absence of disclosure requirements on judgments made to identify contracts. Similar to the Original ED, the Revised ED does not have explicit disclosure requirements related to contract definition judgments and revenue impacts, which makes assessing the impact of these decisions challenging for investors.

Contract Definition Disclosures Remain Unaddressed in the Revised ED

As noted above, the Revised ED provides no contract definition disclosures. See comments on additional disclosures necessary to support contract definition issues in our separate Revenue Recognition Disclosures, Presentation & Transition comment letter.

[1] Paragraph 17 states that contract combination should occur if two or more contracts are entered at the same time with the same customer (or related parties) and if one or more of the following conditions are met: a) contracts are negotiated as a package with a single commercial objective; b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or c) the goods or services promises in the contracts (or some goods or services promised in the contracts) are a single performance obligation in accordance with Paragraphs 27-30.

Limited Information on How Terms of Contract Impact on Revenue
Evaluating the terms of the contract may not be considered by some as being an important part of identifying the contract with the customer (i.e. Step #1). Nevertheless, as we understand, contract terms can impact the amount and timing of revenue being recognized. For example, contract definitions regarding either: a) entitlement to payment when contract is terminated; or b) whether asset created has an alternative use, could dictate whether revenue is recognized continuously over time, or only on full satisfaction of the performance obligation. This makes it important for investors to understand and anticipate industries where contract terms result in differentiated accounting treatments across companies with the same business model. In addition, there is nothing in the disclosure requirements which facilitate investors understanding that contract terms drive revenue recognition. Rather, investors are left with the impression that transfer of control and performance of obligations drive revenue recognition when, in fact, contract definitions and terms may have an impact.

STEP #2 – IDENTIFY PERFORMANCE OBLIGATIONS

Identifying separate performance obligations is interrelated with the allocation of transaction price (i.e. Step #4) in that they will impact the amount and timing of revenue whenever the distinctive performance obligations are being satisfied in different reporting periods. The ability to identify separate performance obligations was an area of concern for various stakeholders during the commentary on the Original ED with difficulties in application highlighted for complex contracts. In our comment letter on the Original ED, we recommended more robust guidance to facilitate the distinction of performance obligations in a manner that minimized entity-specific subjectivity and earnings manipulation opportunities.

The Original ED required performance obligations to be determined as distinctive based upon their unique function or profit margin. We agree with the Boards' decision not to apply profit margin when determining distinct performance obligations. We also support the shift from considering enforceable to implied promises where a customer has a valid expectation that the entity will transfer a good or service. This shift is consistent with our view that the focus of recognition and measurement should be always be on constructive obligations.

That said, in the Revised ED, we are primarily concerned by the high level specification of these criteria, the lack of explicit disclosure requirements for related judgments, and the lack of sufficient illustrative practical examples. We also retain our previously articulated concern regarding the practical expedients potentially reducing the comparability of revenue reporting across similar companies. 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. We further elaborate on our concerns in the sections that follow.

Difficult for Investors to Judge Robustness of
Criteria for Identifying Separate Performance Obligations – Further Clarification Required

The criteria established for identifying distinct performance obligations as articulated in the Revised ED is specified at such a high-level that we believe it will be difficult for investors to evaluate the appropriateness of management's judgments. The following items need further clarification:

- *Core Principle Needs Clarification and Practical Illustration (i.e. Paragraph 28)* – The core principle of identifying distinct performance obligations is articulated in Paragraph 28 specifying that the determination of distinct performance obligations is based on whether a 'customer can benefit from good or service on its own or together with goods or services that are readily available'. That said, due to the high level specification of the core principle, it is difficult for investors to assess its application across multiple industries.

- *Criteria Regarding Bundling Distinct Performance Obligation Needs Clarification and Practical Illustration (i.e. Paragraph 29)* – An exception to the core principle results from the criteria in Paragraph 29. This paragraph characterizes bundles of goods and/or services as not being distinct when distinct goods or service are interrelated, require significant integration and the bundle of goods or services is significantly customized. As a result, the entity will account for interrelated goods or services that require significant integration and customization as a single performance obligation.

  Whereas the guidance discusses the applicability of significant integration judgment in the context of the construction industry, it is not clear how the determination of whether there is significant integration will be made in the context of many other industries (e.g. software). The criteria in Paragraph 29 need further conceptual clarification and practical illustration to ensure consistent application in practice as well as investor understanding of reported revenue patterns.

- *Same Pattern of Transfer Expedient Needs Clarification (i.e. Paragraph 30)* – Another exception to the core principle could arise due to Paragraph 30 where distinct performance obligations that have the same pattern of transfer (e.g. delivered over same time or repetitive activities occurring sequentially) could be considered as a single performance obligation. This latter exception has been described as a practical expedient. However, it is difficult from review of the Revised ED for investors to have an appreciation of the industries where this is likely to be applied and for that reason, we recommend providing illustrative practical examples.

- *Interdependence with Contract Definition (i.e. Step #1) Needs Clarification* – As we highlighted when discussing contract definition, we also believe that there is need for greater illustration through practical examples of the interaction between Step #2 and the decisions made under Step #1 (i.e. the contract combination and modification decision).

Overall, we believe investors will find it difficult to effectively evaluate whether the amount, timing and uncertainty of revenue related to multiple-element arrangements corresponds to the underlying economics and whether similar companies are accounting for revenue in a comparable fashion. We recommend further clarification on the practical application of the proposed criteria through sufficient examples across the industries where these criteria will likely apply.

See also the discussion below regarding the lack of disclosures which will further exacerbate the lack of investor understanding.

Practical Expedients Could Reduce Comparability and Information Content of Reported Revenue
We are concerned that the practical expedients (i.e. Paragraphs 28(a) and 30) will reduce the comparability of reported revenue. There is no guarantee that two economically similar companies will report revenues on the same basis, if one applies this practical expedient and the other does not. Our concern is exacerbated by the high-level definition of the principle and the absence of sufficient illustrative examples related to these paragraphs as described previously.

The practical expedient in Paragraphs 28 (a) requires that the judgment of whether a good or service can be sold to be based purely on the entity's stand-alone sales. Effectively, the determination of the distinct nature of a good or services will be an entity specific judgment. We disagree with the reasons provided in the basis of conclusion (i.e. Paragraph BC 74) where it is stated that the experience of other entities was not relevant for determining whether a good or service in distinct. As in all other areas of accounting (e.g. measurement of assets and liabilities), primacy should be accorded to observable external evidence as this reduces subjectivity associated with entity-specific judgments. Granting companies the option to ignore external evidence of whether a good or service can be sold will reduce the comparability of reported revenue.

In addition, we remain concerned about the retention of the practical expedient in Paragraph 30 which had also been allowed during the Original ED. We repeat our previously raised concerns about this approach which will allow companies to combine performance obligations due to their delivery occurring at the same time. Investors need to know the nature and magnitude of different drivers of the aggregate revenue regardless of whether delivery occurred at the same time. The proposed approach could result in reduced visibility of the distinct nature of some performance obligations in situations where they are combined with other performance obligations.

Conceptual Basis of Identifying "Revenue Adjustments"
As Distinct Performance Obligations, or Not, Is Not Clear
As articulated in our separate Revenue Recognition – Disclosures, Presentation & Transition (i.e. Part I) comment letter, there is need to clarify the basis of identifying certain "revenue adjustments" as separate performance obligations. We define "revenue adjustments" to include items such as warranties, incentives, rebates, refunds (in cash and in-kind), options, etc. Neither the Revised ED nor 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). It is also not clear whether "revenue adjustments" that are treated as separate performance (e.g. warranties which can be purchased separately) have any further distinguishing characteristics, or meet different criteria from those articulated in Paragraphs 27 to 30 related to identifying separate performance obligations. Finally, as noted in Part I of our response, we propose 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 is likely to vary in practice.

Lack of Disclosures Regarding Methods for Identifying Separate Performance Obligations
Remains Unaddressed in the Revised ED
There are no disclosure requirements related to the manner of identifying separate performance obligations. See further comments on additional disclosures necessary to communicate the judgements made in identifying separate performance obligations in our separate Revenue Recognition – Disclosures, Presentation & Transition comment letter.

STEP #3 – DETERMINE TRANSACTION PRICE (QUESTIONS #2 & #3)

Determining transaction price in Step #3 primarily affects the amount of income that is recognized. The main elements to determine transaction price upon which we will comment are set forth below and the sections which follow articulate our comments on these elements:

- Credit risk;
- Variable consideration; and
- Time value of money.

In addition to our comments on the above issues, we support the proposals articulated in Paragraphs IN 16(c) and IN 16(d) to: a) include non-cash consideration on a fair value basis; and b) to offset receivable customer consideration with consideration payable to customers.

CREDIT RISK COMMENTS (QUESTION #2)

Under current practice[2] revenue is only recognized when there is reasonable assurance of collectability. In other words, revenue is only recognized when a recognition collectability threshold has been achieved. The amount which was not reasonably assured of being collectible was netted against the presentation of revenue and was generally never disclosed to investors. Most investors viewed bad debt expense as the only measure of uncollectible revenue rather than realizing that some element of revenue was never recognized because it was not reasonably assured. The Original ED had proposed to incorporate revenue collectability risk by adjusting 'how much' revenue is recognized based upon whether or not it was reasonably assured. The Original ED required preparers to make an assessment of the amounts of revenue which were expected to be uncollectible and then present them as a reduction of revenue with subsequent adjustments in uncollectible amounts reflected in a separate line item in the financial statements – some were desirous of that being a contra revenue account, while others wanted these amounts to be presented in expenses similar to bad debt expense. The Revised ED no longer requires the credit risk adjustment to be deducted from the gross revenue amount as it is done today or how it might have been done under the Original ED. Rather, the Revised ED requires revenue be presented gross and the assessment of the collectability of revenue to be made under the yet to be finalized financial instruments impairment guidance. These uncollectible amounts – both initial and subsequent estimates of uncollectible amounts – would be presented as a reduction of revenue. As we elaborate more extensively in Part I of our letter on Revenue Recognition – Disclosures, Presentation & Transition, and as we have witnessed in discussions with other investors, the Boards has not sufficiently articulated the change in approach to revenue recognition from current practice or from the Original ED. In discussions with investors, the issue is communicated as a change in presentation – which is only part of the story. To be able to obtain meaningful feedback from investors, the change from existing practice must be appropriately communicated. Further, there is confusion regarding the application of the reasonably assured threshold in the determination of collectible revenue under current practice and how that term is being used under the Revised ED.

The reasons for not having a recognition threshold are provided in Paragraph BC 170[3] in the Basis of Conclusion indicating that a meaningful collectability threshold is difficult to construct. As noted

[2] Under IFRS, IAS 18 specifies that revenue is recognized only when 'it is probable that economic benefits will flow to the entity.'

[3] Paragraph BC 170 states that 'In reaching the conclusion not to have a recognition threshold, the Boards noted the following consequences of having collectability as a recognition criterion: a) the Boards would have to specify a probability threshold (for example, reasonable assured or probable) that must be passed before revenue is recognized; b) in many cases, collectability is assessed at a portfolio level because an entity typically does not know which customer will default.

previously, the Revised ED proposes the presentation of the credit risk adjustment adjacent to gross revenue with subsequent updates of assumptions with respect to credit risk presented on this same line. Effectively, credit risk is addressed as a presentation issue under the Revised ED and no longer as a factor that influences the recognition or measurement of gross revenue. The determination of uncollectible amounts is determined under separate guidance. We are strongly supportive of the proposed adjacent presentation of credit as it increases the information content related to underlying gross revenue and the impairments related to revenue. However, we believe the change needs to be more clearly communicated to stakeholders. We elaborate on our views on this proposed requirement in the sections that follow.

Adjacent Presentation of Credit Risk Improves Transparency for Investors:
It Is the Only Acceptable Alternative to a 'When or How Much' Gross Revenue Framework

Our strong support for the proposed separate presentation of credit risk amounts adjacent to revenue is based upon the following:

- *Credit Risk Information is Necessary for Future Cash Flow Prediction* – The joint CFA Institute webcast with the IASB and FASB on revenue recognition showed that 63 percent of respondents found information about uncollectibility of revenue to be useful. Credit risk is considered by investors in their analytical models when they are predicting revenue related future cash flows.
- *Linked Presentation Enhances Transparency and User Access to Credit Risk Information* – The aforementioned webcast also showed that 20 percent of respondents struggled to find the location of revenue credit risk adjustments. The proposed adjacent presentation requirement is an improvement to financial reporting as it applies a linked presentation principle and provides greater transparency on gross revenues earned and impairments associated with revenues. All things being equal, compared to current practice where uncollectible risk is commingled under the bad debt expense, it will be easier for investors to track revenue related credit risk under the proposed presentation.
- *No Additional Cost or Complexity For Preparers* – This proposal is beneficial for investors and it does not impose additional costs for preparers. Therefore, it is hard to fathom why more transparent and linked presentation of revenue related impairments is of such concern to preparers of financial statements. Typically preparers make objections to changes based on significant increases in cost, compliance complexity, concerns about disclosing proprietary information or based on their understanding that particular information is not relevant for users. However, it is hard to see how any of these staple objections applies to this proposed change.
- *Presentation is The Only Acceptable Alternative to 'When or How Much' Gross Revenue Framework* – Many commentators who are opposing the adjacent presentation are failing to fully factor that credit risk is not considered in determining 'when or how much' of revenue. If the current practice presentation requirements are retained and no adjacent presentation of credit risk, we will have a situation where the quality of financial reports will have significantly worsened because gross revenue and associated credit risk will no longer be inextricably linked as proposed under both the Original and Revised ED and as is required under current practice. The only line of argument for not having adjacent presentation seems to be familiarity with current requirements and this is not compelling as no change will ever occur if the focus is retaining the most familiar at the expense of bypassing improvement opportunities.

Consequently, a revenue recognition hurdle may be difficult to apply to individual contracts; c) it would be inconsistent with the accounting for a receivable, which incorporates assessments of collectability in the measurement of that financial asset.'

Disaggregation of Credit Risk Amount through Disclosures is Required
See comments on additional disclosures necessary for investors to appropriately assess credit risk in our separate comment letter on Revenue Recognition – Disclosures, Presentation & Transition.

Need for Further Elaboration of Contract Asset Impairment Requirements
There are several revenue related balance sheet items that could experience economic impairments. These items include accounts receivable and contract assets. The guidance specifies that the financial instruments standards will dictate the impairment of accounts receivable. We agree that the financial instruments accounting standards should dictate the impairment of accounts receivable so that a consistent approach is applied across standards. However, we are concerned that there is no discussion of impairments of contract assets. The underlying argument for not considering credit risk impairment of contract assets seems to be that they do not qualify as financial instruments and are, therefore, considered to be outside the scope of coverage. That said, this is not a compelling reason for failure to evaluate the impairment requirements. We recommend that the final standard should comprehensively address impairments of accounts receivable and contract assets. We also recommend that the final standard explicitly state the balance sheet account where the credit risk adjustment will be reflected. In other words, clarify whether this amount is reflected as a reduction of accounts receivable, a contra asset, or as a liability for unrecognized revenue.

VARIABLE CONSIDERATION COMMENTS (QUESTION #3)

Measuring variable consideration is relevant in determining the transaction price for Step #3. The measurement of variable consideration also affects the amount and timing of revenue recognized under Step #5. We have the following concerns regarding the determination of variable consideration:

- Need for further conceptual development of key terms including reasonably assured constraint;
- Need for better conceptual distinction of variable, uncertain and contingent consideration;
- Allowing both "expected value" and "most likely amount" measurement increases subjectivity; and
- Variable consideration and reasonably assured threshold disclosures required.

We elaborate on these concerns in the sections that follow.

Need for Further Conceptual Development of Key Terms:
Reasonably Assured Constraint Needs Clarification

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'.

In principle, we would assume that entitled consideration ought to be numerically equivalent with expected consideration – only then would the entitled consideration amounts have predictive value for expected future cash flows from revenue. In addition, there are several areas that need further conceptual development before we can meaningfully judge whether the proposed approach will yield revenue amounts that have predictive value and are comparable across similar reporting entities. For example, there is need for clarification regarding how the reasonably assured constraint will be applied in practice. Paragraph BC 201 of the Basis of Conclusion states that the constraint is a qualitative threshold rather than a quantitative threshold. The vague definition of requirements related to the constraint could in unintended fashion contribute to incomparable revenue recognition practices. Paragraph BC 201 also draws a distinction between 'reasonably assured' and 'reasonably estimated', but it is difficult to discern how the judgment of reasonably assured can be made without reasonable estimation. In sum, we can only be fully supportive of this proposed approach if there is further strengthening of the conceptual foundations.

Need for Better Conceptual Distinction of Variable, Uncertain and Contingent Consideration
When characterizing the nature of consideration the terms variable, uncertain and contingent are used as interchangeable terms across the Original ED and Revised ED despite there being a conceptual difference between variable and uncertain consideration[4]. There is one acknowledgment of the distinction between variable and uncertain consideration in respect of the application of these terms towards the allocation of contingent consideration in relation to particular distinct performance obligations (i.e. Step #4).

In the context of evaluating uncertainty in respect of entitlement to consideration one has to consider at least one of the following factors: uncertainty of the amount and the limited likelihood of entitlement to consideration. Uncertainty of amount may, in some cases, be due to variability of possible amounts. It could also be due to difficulty in predicting as a result of limited information. Thus, the judgment of uncertainty of consideration may or may not be based on assessing variable consideration. For example, the distribution of the likely entitled consideration may not be highly variable but simply unknown at a particular point of evaluation (i.e. uncertainty of amount). Therefore, we recommend that the Boards develop robust definitions that make clear a distinction between the terms variable, uncertain and contingent when applied in relation to customer consideration.

Allowing Both "Expected Value" and "Most Likely Amount" Measurement Increases Subjectivity
The Revised ED proposes to allow both the "probability-weighted" and the "most likely" measurement approaches in the determination of variable consideration. The approach chosen will depend upon which method management expects to have the best predictive value. This is a shift from the Original ED's requirement to use a probability-weighted approach. 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. We also believe the final standard should clarify the methodology for determining the "most likely amount" so as to ensure comparable accounting practices by those who apply this method.

Variable/Uncertain Consideration Disclosures Required
See comments on the need for additional disclosures associated with variable and/or uncertain consideration and the application of the reasonably assured threshold in our separate Revenue Recognition – Disclosures, Presentation & Transition comment letter.

[4] Variable considerations connotes a wide range of potential outcomes while uncertain consideration connotes unpredictability due to limited information. For example, variable consideration can be described as arising when an entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts. On the other hand, a selling price can be uncertain when an entity has not yet established a price for a good or service and the good or service has not been previously sold.

TIME VALUE OF MONEY ADJUSTMENT

Incorporation of Time Value of Money is Appropriate

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. Although we are generally concerned about practical expedients when these are allowed to be applied on an optional basis, in this instance, we are supportive of the proposed exemption of time value determination for time differences between satisfied performance obligations and receipt of cash consideration of less than one year. We believe that the time value component of less than one year is likely to be immaterial.

Time Value Adjustment for Performance Obligations Satisfied over Time Needs Clarification

Performance obligations satisfied over time could potentially entail multiple cash inflows that differ from the related multiple performance obligations being satisfied. This makes the determination of time value for performance obligations satisfied over time to be inherently more complex than the time value determination of performance obligations satisfied at a point in time. Addressing continuous/multiple period performance obligations should, from a conceptual standpoint, entail discounting different cash flows using different interest rates. The applicable interest rates should be derived from a term structure analysis of expected forward interest rates. The same type of multi-period, time value discounting could apply to distinct components of multiple element performance obligations being satisfied during different time periods. Thus, there is need for clarification regarding the time value related discounting related to contract situations where there are multiple differences between cash inflows and satisfaction of performance obligations being satisfied.

Discount Rate Is an Unresolved Cross-Cutting Issue

We would observe that the method for determining the discount rate and the need to update discount rates in subsequent measurement is an unresolved cross-cutting and Conceptual Framework issue which should be resolved by the Boards.

Presentation 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 on the financing section of the cash flow statement.

Discount Rate Disclosures Required

Our separate comment letter on Revenue Recognition Disclosures, Presentation & Transition provides our views on the additional disclosures needed related to the discount rate.

STEP #4 - ALLOCATE TRANSACTION PRICE

The Revised ED requirements for allocating transaction price have not been significantly enhanced from an investor perspective from the Original ED. In fact, we find nothing which is investor friendly in the changes from the Original ED to the Revised ED. We believe the Revised ED provides a smorgasbord of alternatives for preparers without sufficient disclosures to enable investors to evaluate the quality of the revenue recognition principles. We are concerned about the subjectivity and auditability of some of the inputs and methods that are used to allocate transaction price. For these reasons, we reiterate below our primary concerns regarding the proposed approaches to allocating transaction price.

Use of Estimated Selling Prices Increases the Overall Subjectivity of Reporting
As noted, we reiterate our earlier concerns that increased subjectivity and earnings management (e.g. front loading of revenues) will likely result from the use of estimated selling prices. Unlike previous requirements to utilize fair value evidence (i.e. vendor specific objective evidence (VSOE)) to differentiate distinct performance obligations under US GAAP for software transactions, the ability to use estimated selling prices for future, high risk performance obligations will provide preparers leeway to front load revenues by the use of low estimated selling prices for these types of uncertain, future performance obligations. As articulated in our earlier comment letter, we are concerned by the lack of 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.

Definition of Hierarchy Necessary to Operationalize Prioritization of Market Based Inputs for Estimated Selling Prices

Paragraphs 70 to 73 allows companies to use estimated selling price in the absence of stand-alone selling prices based on directly observable market prices. Although, the language in Paragraph 73 states that an entity shall maximize the use of observable data, we do not believe that this broad principle will guarantee that preparers will sufficiently prioritize market-oriented inputs when using estimated selling price of performance obligations during transaction price allocation. The primacy of market based evidence can be instilled by the definition of a hierarchy of market inputs but the Revised ED does not provide such a hierarchy as we had proposed in our response to the Original ED.

To mitigate the potential for subjectivity and earnings management, we reiterate our previously articulated strong recommendation that there should be a hierarchy with respect to the determination of this estimated selling price. This hierarchy should prioritize the application of available market evidence and it should also necessitate higher levels of disclosure, including the basis of estimation of these selling prices, for any management estimates that are not based on objective evidence. We suggested that the final standard require reporting entities to apply the following hierarchy of entity-specific entry prices, from most reliable to least reliable:

- Level 1 – Current sales price charged by the entity in an active market.
- Level 2 – Current sales price of competitors in an active market.
- Level 3 – Current sales price charged by the entity in an inactive market.
- Level 4 – Current sales price charged by competitors in an inactive market.
- Level 5 – Estimates of sales prices using entity-specific inputs that reflect the entity's own internal assumptions.

Residual Approach Increases Subjectivity & Decreases Comparability

Stand-alone selling price can be determined based on either observable market evidence or based on estimated selling prices. In addition, if the selling price of a distinct good or service is highly variable[5] or uncertain[6], it can be determined on a residual basis (i.e. residual approach). The residual approach is allowed when there is limited information regarding the selling price of some of the underlying distinct performance obligations. The residual approach derives the stand-alone selling price by making reference to the total transaction price less the sum of observable stand-alone selling prices of other goods or services promised in the contract. We are concerned that allowing the residual approach will add to the overall subjectivity arising due to internal estimates of selling price.

[5] An entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts.

[6] A selling price is uncertain when an entity has not yet established a price for a good or service and the good or service has not been previously sold.

Flexibility of Discount Allocation Methods Only Adds More Subjectivity

Paragraphs 75 and 76 allow a departure from the default relative stand-alone selling price in relation to the allocation of discounts and contingent consideration. We agree that contingent consideration should be allocated to the respective distinct performance obligations. That said, the concern about relative stand-alone selling price allocation for discounts appears to primarily stem from the reluctance of preparers to depict some of their distinct performance obligations as loss-making. Besides, discounts are typically negotiated or granted with the customer taking into account the utility expected to be derived from the particular bundle of goods and/or services. The customer is not necessarily privy to pricing and profitability of individual constituent distinct performance obligations when judging an acceptable discount. We are, therefore, concerned about the flexibility accorded through Paragraph 75 to allocate discounts to distinct performance obligations, as the allocation could be made purely to avoid reflecting distinct performance obligations as loss-making. This requirement simply adds yet another layer of management discretion and the ability to influence the timing of reported revenue.

Scope Exclusion of Loss Recognition Related to Onerous Performance Obligations that are Satisfied at a Point in Time Exacerbates our Concerns about Subjectivity of Models

The Revised ED has excluded from its scope, the recognition of losses due to performance obligations that are satisfied at a point in time. This exclusion exacerbates our concern about the increased subjectivity in revenue recognition and measurement during transaction price allocation. 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.

Need Specific and Robust Disclosure Requirements for Estimated Selling Prices & Allocation Methods

The Revenue Recognition – Disclosures, Presentation & Transition comment letter provides additional disclosures necessary to support allocation of transaction price.

STEP # 5 – SATISFY PERFORMANCE OBLIGATION (QUESTION #1)

In our response to the Original ED, we articulated a widely shared concern about the robustness of the model for service industries and generally where performance obligations are satisfied over time. We also proposed that a risk-reward assessment should be included as an indicator of transfer of control. We acknowledge that the Revised ED has, to some extent, addressed our concerns by including the risk-reward assessment and also by providing guidance for performance obligations that are satisfied over time. In addition, we are supportive of inclusion of customer acceptance as an indicator of transfer of control.

That said, we reiterate our earlier assertion that the consistency of reporting practices across companies can only occur, when the conceptual foundations of accounting standards consist of robustly defined principles that are conveyed through unambiguous language and validated by sufficient illustrative guidance across the relevant industries which will be impacted. Though Step #5 is arguably the most critical step for revenue recognition purposes, as currently articulated it is also one of the more challenging steps for investors and other stakeholders to correctly interpret and, thereafter, for them to appropriately anticipate the impacts on the amount, timing and uncertainty of revenue recognition. It is our view that the Revised ED has not clearly defined, nor has it adequately highlighted, the practical implications of these newly introduced criteria. Thus, investors will not readily be aware of the economic consequences of these criteria across applicable industries. Thus, the final standard should sufficiently clarify and highlight the practical implications of these newly introduced criteria.

In the Revised ED, the criteria for recognizing revenue for performance obligations that are satisfied over time is described in Paragraphs 35 and 36 of the Revised ED. Paragraph 35 states that if either of the two following conditions are met then a performance obligation is considered to be satisfied over time. Those conditions include:

a) The customer maintains control of the asset as the entity creates or enhances the asset; or
b) The entity's performance creates an asset where there is no alternative use of asset created; and at least one of a number of other conditions including the following is met:
   (i) there is simultaneity of production and consumption;
   (ii) there is no need for re-performance if termination of contract occurs before completion; and
   (iii) entitlement to payment exists for proportion of performance that has been completed.

We acknowledge that the Revised ED has provided additional guidance related to performance obligations that are satisfied over time including those that relate to service industries. 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. We highlight several required disclosure enhancements. We elaborate on these concerns in the sections that follow.

Measurement of Performance Obligations Satisfied Over Time:
Definition of Core Principle of Transfer of Control Still Needs Enhancement

Determination of transfer of control is a core building block for the revenue recognition model. In addition, for greater objectivity and also to be conceptually consistent with transaction price allocation being based on customer consideration, transfer of control should primarily be considered from the point of view of the customer. In other words, the question should be whether control of the good or service being delivered, has been transferred from seller to customer. That said, we also recognize that the determination of transfer of control to customers can be difficult to assess in certain instances, such as for particular services and, more generally, for performance obligations that are being satisfied over time. We understand that it is on the basis of this difficulty that a sellers' perspective of transfer of control (e.g. assets with no alternative use) is being allowed within the Revised ED.

Nevertheless, we would expect that primacy of transfer of control from the point of view of the customer should be explicitly stated within the language of the final standard. The proposed guidance does not clearly illustrate whether primacy is accorded to judgments of transfer of control that are made from the point of view of the customer. Only the Basis of Conclusion Paragraph BC86 refers to primacy of transfer of control from point of view of customer and we do not consider a discussion in the Basis of Conclusion to be sufficient. According primacy to a customer based judgment of transfer of control is important. Otherwise, companies would have flexibility to accelerate revenue if they can shape the parameters (e.g. contract terms) of whether they are considered to control a created asset or not.

Therefore, we recommend that the definition of transfer of control across Paragraphs 31-33 and 35-37 should make a clear distinction between judgments being made from the point of view of either the customer or seller. In addition, there should be primacy of indicators that are based on transfer of control to the customer and only, thereafter, should transfer of control be inferred from the point of view of seller.

Measurement of Performance Obligations Satisfied Over Time:
Lack of Distinctive Guidance for Goods versus Services

The proposed guidance is not adequate in helping to understand how transfer of control occurs for services in all instances. The guidance required for services seems to have been subsumed as part of the guidance for performance obligations that are satisfied over time in Paragraphs 35 and 36. However, it is not clear whether the guidance in Paragraphs 35 and 36 is also meant for service performance obligations that are satisfied at a point in time.

Although the basis of conclusion (Paragraph BC 88) highlights the difficulties faced by the Boards in defining services and, thereafter, developing a specific revenue recognition approach for services, strengthening the guidance for services is necessary to help users to understand the nature of revenue arising from good or services. Better guidance for services would also be consistent with the SEC requirements for the distinctions to be made between revenue from goods or services in the presentation of such items in the income statement.

Measurement of Performance Obligations Satisfied Over Time: Criteria Require Clarification & Enhancement

Our view is that application of criteria to determine whether performance obligations are satisfied over time needs further enhancement. A number of new concepts and criteria have been introduced through Paragraphs 35 and 36. As we understand, these criteria are meant to help operationalize the transfer of control notion for performance obligations that are satisfied over time. However, the communication about the application of these criteria is confusing and there are still several questions that will require clarification prior to these criteria resulting in consistent and comparable accounting of revenue related transactions that are economically similar. We elaborate on confusion created by the criteria and the enhancement requirements below in the sections which follow.

Criteria Do Not Reflect Any Notion of Time: "Passage of Time" or "Performance Over Time"

Though the notion of performance obligations occurring over multiple time periods is implied by the preceding heading of 'performance obligations satisfied over time,' the language in Paragraphs 35 and 36 does not explicitly indicate that the applicability of these paragraphs only arises when there is passage of time. In other words, there is no explicit linkage to the concept of time in the requirements. As such it is difficult to articulate to users the principles and their relationship to the passage of time and it is not clear that these paragraphs only apply for performance obligations arising from long-duration/multiple-period contracts. The final standard should explicitly include the 'passage of time' dimension into all the related paragraphs in order to minimize the risk of confusion in situations where these criteria could also apply for performance obligations that are satisfied at a point in time.

Sub-Criteria Related to "No Alternative Use" Don't Appear to Be Indicators Specific to Performance Over Time or An Asset Having No Alternative Use

It is not clear why the sub Paragraphs 35 b (i) (simultaneous receipt & consumption), (ii) (no need to substantially reperform) and (iii) (right-to-payment) are indicators that a performance obligation is satisfied over time or considered to be strictly associated with the criterion of "no assets created with an alternative use." Any these sub-paragraphs could be associated with Paragraph 35 (a) where the entity's performance enhances or creates an asset under the customer's control. For example, if as a form of asset enhancement, a customer took their Mercedes Benz to a garage for repainting and the job was halted after painting for 60% of the car has occurred both sub Paragraphs 35 (a) & 35 b (ii) could apply. This is because the customer still controls the asset being enhanced (i.e. Mercedes Benz) and if after termination they took the car to another garage only 40 percent of the car would need to be repainted.

Why Aren't Alternative Use Sub-Criteria Stand-Alone Criteria if They Are Meaningful?

Paragraphs 35 (b)(i), (ii), & (iii) – if relevant to the determination of performance over time in the context of alternative use concept – could also arguably sufficiently apply on a stand-alone basis as indicators of performance occurring over time.

Creation of Assets with No Alternative Use Needs Further Definition

Another issue arises due to the terminology used in Paragraph 35 (b). The language in this paragraph refers to 'entity does not create assets with an alternative use'. This phrase is confusing. We recommend that for greater clarity of application and interpretation, the phrase 'entity performance does not create an asset with an alternative use to the entity' should be broken down into its two implied states namely that: 'satisfied performance obligations with no assets created'; or 'satisfied performance obligations with assets created that have no alternative use to the entity'. Thereafter revenue recognition criteria should be articulated for each of these two distinct states. It is difficult to understand how transfer of control occurs if no assets are created especially given that Paragraph 32 states that all goods and services are assets. Transfer of control seems to be appropriate as a basis of revenue recognition only if assets are created and

transferred to customers. For the situations where there are no assets created, transfer of control would seem to be a moot point. Thus, it is necessary to further substantiate with examples regarding the type of situations that can result in performance obligations being satisfied but with no assets are created.

<u>Right to Payment as Revenue Recognition Criteria Is Conceptually Inconsistent With Overall Model</u>
Paragraph 35 (b) (iii) includes entitlement to payment for performance if a contract is terminated as one of the criteria for determining whether transfer of control has occurred, for performance obligations that are satisfied over time. We concur with the viewpoint expressed in Mr. Linsmeier's dissenting opinion. This criterion is not being consistent with the core principle of satisfaction of performance obligation being based on transfer of control. The Revised ED fails to sufficiently explain why entitlement to payment for completed performance is an appropriate indicator of transfer of control for performance obligations that are satisfied over time and not for point in time performance obligations.

Measurement of Performance Obligations Satisfied Over Time:
Alternative Use of Asset as Criterion May Distort Revenue Recognition
The production of assets that have no alternative use ought to be inherently a riskier activity than the production of assets that can be sold to more than a single customer. Therefore, it seems counter-intuitive that the production of a good/service with no alternative use should yield accelerated recognition of revenue as would occur with the application of the criteria in Paragraph 35. Said differently, recognition of revenue over time – rather than upon "transfer of control" which would fully occur at the completion of the performance obligation – has the impact of recognizing revenue earlier.

In addition, in response to feedback on the Original ED, the Revised ED has disallowed the consideration of exclusivity as a criterion of determining whether to recognize revenue for licenses of intellectual property, over time or at a point in time. Therefore, it seems conceptually inconsistent to allow the "no alternative use" as a criterion of whether to recognize revenue at a point in time or over time but not consider exclusivity for licenses of intellectual property.

There also seems to be a low hurdle for preparers to qualify assets created as having no alternative use. Paragraph 36 states that judgment of assets created having no alternative use can be made based on contract terms and practical limitations. Allowing the determination of the alternative use of assets to be based on contract definition also exacerbates an earlier noted concern that the terms of a contract dictate the revenue recognition method and may potentially result in similar economic transactions having different accounting methods. As we understand, the Revised ED intends that the contract definition of no alternative use of asset should be based on such a judgment being made at contract inception. That said, it is not clear whether changes in the economic environment during the life of the contract will result in a change of judgments regarding there being no alternative use of the asset and thereafter the eligibility for performance obligations satisfied over time. For example, if, unlike the circumstances at contract inception, there is subsequent evidence of their being other customers for the contract goods or service. Said differently, it is not clear whether contract terms are allowed to trump judgments from prevailing economic circumstances on whether there is single or multiple customer demand for the contract goods or services in determining the accounting method.

Measurement of Performance Obligations Satisfied Over Time:
Input Methods Should Not Be Allowed

It is our view, that financial statement preparers will have significant latitude to elect either input or output based methods whilst measuring the progress towards complete satisfaction of a performance obligation. The need to elect either of these methods arises in situations where the performance obligation is satisfied over time (i.e. Though we would re-emphasize that neither of the "over time" criteria in Paragraph 35 are associated with time). That said, we are concerned that input based methods can result in the recognition of revenue in a manner that does not correspond to the pattern of transfer of control to customers. Thus, in contrast to the Revised ED, we recommend the prohibition of input methods. If these are allowed there should be a hierarchy of acceptable methods with input methods only being allowed in the absence of output methods and with expanded disclosures regarding the nature of data applied.

Paragraphs 47 and 48 of the Revised ED, state that an entity shall recognize revenue for performance obligations satisfied over time only if the entity can reasonably measure its progress towards complete satisfaction of the performance obligation. These paragraphs also state that an entity would not be able to reasonably measure its progress towards complete satisfaction of a performance obligation if it lacks reliable information required to apply an appropriate method. Although, we agree with the principle of only allowing reliable information, these paragraphs are silent on criteria of characterizing information as unreliable. The purely principles-based specification of whether to apply the input or output methods, gives leeway for preparers to determine what constitutes reliable information with guidance or anti-abuse measures, and these claims will be difficult to verify. In other words, it is likely that entities will always declare the information they desire to use as reliable.

Measurement of Performance Obligations Satisfied At A Point In Time:
Guidance Regarding Bill-and-Hold Transaction Omits Fixed Delivery Schedule (SAB 101 Criteria)

Under US GAAP, the SEC has provided guidance for bill-and-hold transactions through Staff Accounting Bulletin No.101 (SAB 101)[7]. The guidance requires that there be a fixed schedule for delivery of the goods and that the date of delivery must be reasonable and consistent with the buyer's business purpose. As currently written, Paragraphs B51-B54 (specifically, Paragraph B53) do not include a similar requirement. It is our understanding that some view this as adding flexibility in determining when revenue can be recognized under a transfer of control notion. For that reasons, we recommend that the Boards consider whether this criteria should be included in the final standard in relation to bill-and-hold transactions.

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[7] The SEC has set forth criteria to be met in order to recognize revenue when delivery has not occurred (i.e. bill-and-hold). These include:

1. The risks of ownership must have passed to the buyer;
2. The customer must have made a fixed commitment to purchase the goods, preferably in written documentation;
3. The buyer, not the seller, must request that the transaction be on a bill and hold basis. The buyer must have a substantial business purpose for ordering the goods on a bill and hold basis;
4. There must be a fixed schedule for delivery of the goods. The date for delivery must be reasonable and must be consistent with the buyer's business purpose (e.g. storage periods are customary in the industry);
5. The seller must not have retained any specific performance obligations such that the earning process is not complete;
6. The ordered goods must have been segregated from the seller's inventory and not be subject to being used to fill other orders; and
7. The equipment [product] must be complete and ready for shipment.

Measurement of Performance Obligations Satisfied Over Time or At A Point In Time: Disclosure Enhancements Required

See comments on additional disclosures necessary to support Step #5 in the separate Revenue Recognition Disclosures, Presentation & Transition comment letter.

As it relates to the defense and aerospace industry, the SEC has recently commented to registrants regarding the requirement, in FASB Accounting Standards Codification (ASC) 250, to disclose the impact of the change in estimates on long-term contracts when companies apply percentage-of-completion accounting. When using percentage-of-completion accounting, the SEC believes registrants ought to have the ability to make reasonably dependable estimates of contract revenues and costs and the extent of progress towards completion. We would highlight the need for the following disclosures[8] that have been requested by the SEC:

- A description of the contract estimation process and how profit adjustments arise;
- Expanded quantitative disclosure of the gross favorable and unfavorable profit adjustments for each period presented; and
- A description of any significant adjustments made to individual contract estimates.

We believe that the ability to utilize an inputs method under the Revised ED should come with similarly specific requirements. With such requirements, entities following such a method under US GAAP and IFRS will be required to provide similar useful disclosures.

[8] Regulation S-K Item 303, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and FASB Accounting Standards Codification 501.14, *Critical Accounting Estimates.*

ONEROUS PERFORMANCE OBLIGATIONS (QUESTION #4)

Performance Obligation as Unit of Account Is Appropriate
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. But it is conceptually inconsistent 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.

Oppose Exemptions (e.g. Loss Recognition Only for Contracts > 12 months)
The Revised ED proposes to exempt the recognition of losses if:
a) performance obligation is satisfied at a point in time, and
b) the satisfaction occurs over a period of one year.

We do not support either of these exemptions. Losses that are bound to occur within the next 12 months are critical to investors' assessment of the prospects of reporting entities. While this may seem to be a logical practical expedient we believe this "rule" will be utilized to push losses from one quarter to the next. Revenues are evaluated quarterly. Accordingly, the notion that a less than twelve-month period is appropriate is not consistent with how revenues are analyzed. There are a multitude of examples where companies experiencing financial difficulties manipulate revenue recognition to manage the top line within yearly periods and from quarter-to-quarter. It is our fear that this expedient gives them an accounting principle "cover" in using the duration of contracts to accomplish earnings manipulation.

Further, excluding an analysis by performance obligation violates the entire underlying principle of the proposed revenue recognition model – a model which suggest the unit of measurement should be the distinct performance obligation.

Onerous Performance Obligations Disclosure Enhancement
See Revenue Recognition Disclosures, Presentation & Transition comment letter for additional disclosures necessary to support cost recognition and measurement issues in the Revised ED.

TRANSFER OF NON-FINANCIAL ASSETS (QUESTION #6)

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. The amendments should apply when considering: a) the control requirements and when to do-recognize an asset; and b) the measurement requirements to determine the amount of gain or loss to recognize upon de-recognition of the asset. This proposal will contribute to conceptual consistency across related standards.

COST RECOGNITION

Deferral of Costs: Clarification of Impact of 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, so 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 Board's 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.

While Paragraphs 91 to 103 articulate which costs need to be expensed as incurred, which can be deferred, and how they should be amortized, they are highly principles based guidelines and there doesn't appear, for the reasons noted in the preceding paragraph, to be a sufficient understanding regarding the potential impact of these proposals by all stakeholders to the standard-setting process.

While we support that only costs directly related to the contract, incremental in nature, and recoverable be deferred, for the reasons noted above, it is challenging to assess the impacts of these decisions. The lack of transparency and discussion regarding the potential impact of these changes makes it especially difficult for investors to assess whether there will be a greater capacity to defer costs related to contracts. This is a concern, given the backdrop of greater discretion being accorded to the manner in which revenue may be recognized as described in previous sections. If companies can accelerate revenue recognition —as we fear because of the use of estimated selling price — but defer contract cost recognition, investors may not obtain an appropriate picture as to the wealth creation of the enterprise.

Amortization of Deferred Costs: Not Being Linked to Performance Obligation Increases Managerial Discretion to Influence Gross Margins
Under the proposed model, revenue recognition is anchored to the identification and satisfaction of distinct performance obligations. Cost deferral as outlined in Paragraphs 91 – 97 is on a contract – not performance obligation – basis. Paragraph 98 of Revised ED states:

> *An asset recognized in accordance with Paragraph 91 or 94 shall be amortized on a systematic basis consistent with the pattern of transfer of goods or services to which the asset relates.*

While the notion that there should be a linkage to the pattern of transfer of goods or services, we believe without specific articulation that costs need to be deferred and amortized by performance obligation there will be aggregation of costs to result in an amortization pattern which will only serve to slow the cost amortization pattern.

We believe this approach accords too much discretion to preparers and does not directly match amortization of deferred costs to the respective performance obligations — the foundation of the revenue recognition model — so as to ensure matching of revenues to related costs.

Amortization of Deferred Costs: Ability to Anticipate Contracts & Renewals Is Not Robust & Will Result in Earnings Management

Paragraph 98 of Revised ED also states:

> *The asset may relate to goods or services to be transferred under an anticipated contract that the entity can identify specifically (for example, services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved.)*

We agree with the views of Mr. Linsmeier as expressed in AV 9(a) regarding the lack of robustness as it relates to the ability to extend the amortization period beyond the original contract period is fraught with potential for earnings management. The guidance needs to be more robust and specific and implementation guidance should be provided.

Impairment of Deferred Costs: Eliminate US GAAP & IFRS Difference Related to Impairment Reversals and Concerns on Impairment Reversals

Under IFRS impairments of deferred costs may be reversed as per Paragraph 103. This is not allowed under US GAAP. Given the Boards have not chosen a current or fair value approach to revenue recognition, the notion that IFRS would allow "writing up" impairments is, in our view, inconsistent with the revenue recognition approach chosen. Due to this inconsistency, the lack of reference to market inputs and our concerns on the vague nature and likely subjectivity of impairment methods, we do not support allowing reversal of impairments. Further, we believe IFRS and US GAAP should converge to the US GAAP approach and eliminate impairment reversals. These differences simply reduce global comparability without adding economic meaning to the analysis.

Cost Disclosures: Additional Cost Disclosures Required To Prevent Against Earnings Management

See Revenue Recognition Disclosures, Presentation & Transition comment letter for additional disclosures necessary to support cost recognition and measurement principles in Revised ED.

See also the discussion under Step #5 regarding the disclosures necessary when the inputs methods is used in a manner similar to the percentage-of-completion approach.