Via Email: rhherz@fasb.org ; dtweedie@iasb.org

Sir David Tweedie, Chairman
International Accounting Standards Board (IASB)

Robert H. Herz, Chairman
US Financial Accounting Standards Board (FASB)

16 Park Crescent
London W1B 1AH
United Kingdom
Tel.: +44 207 612 7098
Fax: +44 207 612 7034
Email: secretariat@icgn.org
Web: www.icgn.org

19 June 2009

Re: Preliminary Views on Revenue Recognition in Contracts with Customers

Dear Sir David and Bob,

We are writing on behalf of the International Corporate Governance Network (ICGN). The ICGN is a global membership organisation of institutional and private investors, corporations and advisors from 45 countries. Our investor members are responsible for global assets of U.S. $9 trillion. The mission of the ICGN is to meaningfully contribute to the continuous improvement of corporate governance best practices through the exchange of ideas and information across borders. Information about the ICGN, its members, and its activities is available on our website: www.icgn.org.

The purpose of the Accounting and Auditing Practices Committee is to address and comment on accounting and auditing practices from an international investor and shareowner perspective. The Committee through collective comment and engagement strives to ensure the quality and integrity of financial reporting around the world.
http://www.icgn.org/advocacy/accounting-and-auditing-practices-committee/

The ICGN is pleased to provide comment to the IASB and the FASB on its joint project on revenue recognition to clarify the principles for recognizing revenue, specifically in contracts with customers. With perhaps overly extensive and prescriptive guidance on revenue recognition in U.S. generally accepted accounting principles (GAAP) and limited and somewhat fragmented guidance provided in International Financial Reporting Standards (IFRSs); the ICGN agrees that a discussion paper to obtain preliminary views and comments is timely and important with the current financial turmoil. ICGN represents investors and capital providers utilizing an entity's revenue to analyze and determine an entity's financial position and its financial performance as a basis for making economic decisions. We believe this joint project is critical and valuable to users (investors, capital providers, preparers, auditors, and regulators) of financial statements.

With this context in mind, we provide you the following comments:

Chapter 2: A Contract-Based Revenue Recognition Principle

Question 1
Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

The ICGN believes that revenue recognition is a very important issue for users of financial statements. Empirical research has clearly indicated that attempts to deceive users most often involve managing revenue recognition. Although we applaud the Boards' ambition to base revenue recognition on a unified set of principles, we do not think that this is the ultimate solution. The inconsistencies that exist in current standards may be further resolved by adding more pragmatic means.

The apparent conflicts between IAS 11 (Construction Contracts) and IAS 18 (Revenue) do not present a serious problem for users although currently the rules governing the use of the percentage of completion method do not always seem logical. It is also important to realize that revenue recognition is a critical issue in transactions based accounting. Although regulation should be based on principles, in this particular area it may be realistic to expect that a fair amount of (industry specific) guidance combined with professional judgment may always be necessary.

The ICGN has no particular objections to the contract assets/contract liability perspective. However, we view this perspective as a clever contrivance designed to connect revenue recognition to the conceptual framework. The key issues related to the timing of revenue recognition are not solved by this mechanism. We do not share the belief that focusing on changes in assets and liabilities could or should "bring discipline to the earnings process approach" (see discussion paper 1.19).

Question 2
Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?
Question 3
Do you agree with the boards' definition of a contract? Why or why not?
Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

We have no response to questions 2 and 3

Chapter 3: Performance Obligations

Question 4
Do you think the boards' proposed definition of a performance obligations would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

Question 5
Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

We will address these issues in our responses to questions 8 and 9 below

Question 6
Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

We do not think that a right of return is a performance obligation. In a sale with right of return the "buyer" may have very little intention of actually acquiring the good in question. It may actually be a trial period based on a Memorandum of Understanding. The probability of an actual transaction may be quite low. The ICGN believes the current regulations regarding rights of return should not be relaxed. For a single transaction, revenue should not be recognized unless the customer has accepted the good in question. In case of a large number of similar transactions the revenue may be recognized provided returns may be reliably estimated based on available data.

Question 7
Do you think that sales incentives (e.g. discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

We do believe that sales incentives give rise to performance obligations. Clearly, the seller has given the buyer rights to future goods or services. How to measure this obligation seems to be the difficult question. However, in principle such a promise has a fair value.

Chapter 4: Satisfaction of Performance Obligations

Question 8
Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

The ICGN believes that the focus on delivery and control here is too narrow. Existing standards take the distribution of risk and return into account as well. We believe the substance of an economic good is related to risk and return. In practice it may sometimes be difficult to describe the distribution of risk and return. However, in most cases the parties involved should have a pretty good idea of the risks and returns that have been retained or transferred. The control concept, on the other hand, is very much a matter of form. Moreover in practice it seems no less challenging to determine who has control.

The ICGN believes both risk and return and control should be taken into account. In most cases these characteristics will reside with the same party. If not, perverse incentives are likely to exist. Such cases should be handled with due care by preparers and auditors alike; the presumptions should be that there are hidden arrangements which should be uncovered and taken into account. We believe that no sale has occurred unless most risks and returns have been transferred to the buyer. Delivery and legal transfer of title is not sufficient if risks and rewards are retained. Conversely, legal control is less important when risk and return have been transferred.

Consider the following example: A shipping company sells a ship to a customer with very little capital. It is agreed that the price will be paid in installments over a number of years and it is obvious that the seller will only receive payment if the market allows the buyer to generate sufficient cash flow. In this case the buyer clearly controls the asset, but all of the downside risk is retained by the seller. Thus

according to the traditional risk and return criterion, revenue is not realized or realizable and may not be recognized. On the other hand, the proposed control criterion would allow revenue to be recognized. We believe the traditional solution (requiring transfer of risk and return) is the correct one, and in cases such as this payment is necessary as an indicator of risk transfer. The claim by the seller is not a financial asset, but an operational one.

Question 9
The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

The Boards propose limitations on the use of the percentage of completion method for revenue recognition. This method may no longer be used for long term production contracts and provision of services unless ownership and control are continuously transferred to the customer. We tend to disagree with this position for several reasons. First of all, we think that instead of the percentage of completion method, it would be an improvement to distinct objectively identifiable stages in the process of completion of a contract for revenue recognition purposes. Secondly, it is far from clear that the criterion proposed by the Boards is operational; we fear that it may lead to extensive legal hair-splitting. Thirdly, whether control is transferred appears to have very little to do with risk and return in these cases. Thus the proposed distinction between the two kinds of long term contracts may have little substance. Fourthly, the percentage of completion method is familiar to users and may provide relevant information about companies earnings power. The Boards do not provide any substantive reason for limiting its use. Finally, we believe that when prices are fixed and costs are reasonably predictable, it makes sense to say that performance is tied to production whether or not this has a legal basis. The performance obligation is extinguished gradually, and it follows that revenue may be recognized continuously. Shareowners and other users of financial reports have sometimes questioned the reliability of revenues and profits derived from incomplete contracts. The ICGN believes the Boards should consider ways of improving the reliability of the percentage of completion method for example by requiring added dislosures.

Chapter 5: Measurement of Performance Obligations

Question 10
In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.
(a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

(b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?

(c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable?
Please provide examples.

(d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

The ICGN agrees that performance obligations should be measured initially at the transactions price. We also agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost if that cost exceeds the carrying amount of the performance obligation. This approach provides investors with relevant and reliable information that is well understood.

We also believe that very few contracts for sale of goods or rendering of services should be excluded from the scope of the standard. In particular, any contract for delivery of non-financial items in accordance with the entity's expected sale of the items should be included. However, we believe the current projects on the insurance industry should be completed as planned.

Question 11
The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (e.g. selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.

(a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?

(b) In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.

We do agree that any costs not directly attributable to a contract, such as marketing costs, should be recognized as expenses even though the price charged from customers would cover these costs. On the other hand such marketing costs should be distinguished from similar costs that are directly attributable to the customer relationship. The costs of establising a mobile phone account for example are significant. The fees charged to cover these costs should be recognized as revenue up front. This could be justified by defining the setting up of the account as a separate performance obligation. In other cases such costs should be capitalized and deferred. This would include commissions. As a valid contract exists there should be no objections to capitalizing such costs. Whether the contract is bought from a dealer or commissions are paid to an agents should make no difference.

Question 12
Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

Question 13
Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

The ICGN supports the allocation of transactions prices on the basis of stand-alone selling prices. If such stand-alone selling prices are not available in the market, estimates must be made. Although allocations schemes may offer opportunities for earnings management, there does not appear to be any realistic

alternatives. In many jurisdictions standard warranties are extensive, and hence there is no market. Still we believe it should be possible to estimate fair values.

The ICGN thanks both Boards for its diligence on this discussion paper, as revenue recognition is an area of accounting which is difficult to record accurately. A recent paper written by Glass Lewis & Company, 'Revenue Recognition for Collaborative Arrangements in the Biotechnology Industry' [1] reflects the need for this project since revenue recognition errors are a leading cause of restatements year after year.

Thank you for the opportunity to provide our comments**.** If you would like to discuss any of these points, please do not hesitate to contact Kerrie Waring, our Chief Operating Officer, at +44 207 612 7079 or kerrie.waring@icgn.org. Thank you for your attention and we look forward to your response on the points above.

Yours sincerely,

Frederic Gielen
Co-Chair, ICGN Accounting and
Auditing Practices Committee

Lou Moret
Co-Chair, ICGN Accounting and
Auditing Practices Committee

[1] Paper Written on 'Revenue Recognition for Collaborative Arrangements in the Biotechnology Industry', Leah Townsend and Terry Baldwin, Senior Research Analysts, Glass Lewis & Co. August 8, 2008.