

Financial Accounting Standards Board
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27 November 2012

International Accounting Standards Board
30 Cannon Street
London
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Dear FASB and IASB members,

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (the Boards) initiated a joint project aimed at clarifying the principles for recognizing revenue and developing a common revenue standard for US GAAP and IFRS intended to, among other things, "improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets and provide more useful information to users of the financial statements through improved disclosure requirements." The Boards plan for the new standard to replace existing revenue standards and a substantial amount of related general practice and specific industry implementation guidance.

In a number of forums, members of the Boards and their staffs have acknowledged the need for a smooth implementation of the new standard and have committed to support this important objective. We applaud the Boards and their staffs for this commitment. We believe providing adequate implementation guidance will be a fundamental element to achieving a smooth implementation of the new standard and encourage the Boards to further their efforts in this important area.

The need for implementation guidance

We believe that in its current state, the proposed standard does not address a significant number of interpretative issues that have been raised during the comment process. A number of these issues have been previously addressed by the Boards, other standard-setting bodies or regulators under existing literature, which, as planned, will be superseded. We are concerned that if the Boards do not address these issues (either in the new standard or as part of a Board-led implementation effort) diversity in practice will arise when the new standard is implemented.

We anticipate this diversity will develop because of many factors, including differences in historical accounting applications and "accepted" industry practices and differing regulatory environments. In areas that are not addressed in the new standard, we anticipate that some entities will continue applying current literature and practice.

We agree that the issuance of principles-based standards is the preferable form of standard-setting; but to be most effective, these principles-based standards should be accompanied by sufficient implementation guidance. Without such guidance, we believe the principles in a new revenue standard likely will not be interpreted and applied in a manner consistent with the Boards' intention. We also are concerned that the extent of implementation guidance in the new standard, based on the Boards' redeliberations to date, will not be sufficient to achieve the Boards' objective of improved comparability across entities, industries, jurisdictions and capital markets. As stated in our comment letter submitted on 13 March 2012 on the revised Exposure Draft (ED), *Revenue from Contracts with Customers*, issued on 14 November 2011, we believe the Boards need to do more work to incorporate additional implementation guidance into the final standard to facilitate consistent application.

As this proposal has evolved, we have noted that our concerns are shared by other interested parties. Many of the comment letters submitted to the FASB and IASB for both the original ED issued in June 2010 and the revised ED issued in November 2011 requested additional clarity and implementation guidance.

How implementation guidance could be provided

We believe that the Boards' primary objective should be the completion of the standard while giving recognition to the need for implementation guidance. By providing a final standard with sufficient lead time to when it becomes effective, stakeholders will have time to assess the impact of the new standard and identify issues that may require further implementation guidance. This may result in the Boards having to continue the joint project after the standard has been issued, to consider necessary implementation guidance or to run a concurrent project to develop the necessary implementation guidance as the standard is finalized. Implementation guidance could be provided in a number of ways including:

- ▶ By embedding the guidance in the proposed new standard
- ▶ Through implementation groups led by or subject to oversight of the Boards
- ▶ By the staffs of the Boards
- ▶ By industry groups in cooperation with the Boards

We anticipate that all of these methods may be appropriate in certain circumstances, depending on the nature or pervasiveness of the issues. Regardless of how and by whom the guidance is provided, it is important for the:

- ▶ Process of developing the guidance to be transparent
- ▶ Guidance to be retrievable and widely available in the public domain to all stakeholders
- ▶ Guidance to be consistent with the principles in the planned new standard as well as the Boards' intent when developing those principles

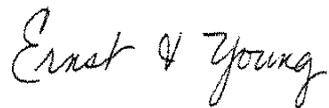
All stakeholders (preparers, users, auditors, standard setters and regulators) should have the opportunity to participate in the process of developing implementation guidance. Such an effort ultimately would improve the effectiveness and application consistency of a new standard.

In our view, all potential implementation guidance should be considered by the Boards. Due to the nature of the standard, much discussion has already commenced in different jurisdictions and different industries on how certain principles should be applied in practice. Without the participation of the Boards in this process, our concern is that the implementation guidance ultimately developed may be inconsistent between different jurisdictions and industries, thereby adversely affecting the comparability of the resulting financial information.

In the Appendix to this letter, we have provided specific illustrations of why specific implementation guidance is necessary. These examples reflect certain highly judgmental and complex areas (which have proved to be challenging to address in practice) where we understand more detailed implementation guidance may not exist under the new standard. We suggest that the Boards consider such matters in the development of the new standard.

We appreciate your consideration of the matters presented in this letter. Should you wish to discuss the contents of this letter with us or be provided further information, please contact Nancy Salisbury on +1 202 327 7855, Jackson Day on + 1 212 773 5266, Ruth Picker on +44 20 7951 3497 or James Luke on +44 20 7951 4773.

Yours faithfully,

A handwritten signature in cursive script that reads 'Ernst & Young'.

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In this Appendix, we have outlined selected areas in which we believe additional implementation guidance is needed to both (1) apply a final standard in a manner consistent with the Boards' intent and (2) to achieve the Boards' objective to "improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets."

Principal versus agent considerations

Today, there are more than 10 examples in ASC 605-45, *Revenue Recognition - Principal Agent Considerations*. These examples illustrate how the guidance in Subtopic 605-45 applies to different types of transactions and include, for example, guidance for arrangements in which an entity is not the primary obligor but may still determine that it is the principal in the transaction. IAS 18 *Revenue* includes an illustrative example, in paragraph IE21, related to principal versus agent considerations. However, IFRS does not include further examples and entities preparing financial statements in accordance with IFRS often look to ASC 605-45 for guidance in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The revised ED, while not significantly changing the basis for making this determination, does not provide any examples illustrating how an entity should apply the principal versus agent considerations to their arrangements.

Based on our experiences applying the current literature in US GAAP and IFRS, we believe that the determination of whether an entity is acting as a principal or an agent can be very subjective and requires significant judgment - under both current guidance and the proposal. We believe this is a matter where practice spends a significant amount of time applying existing literature. Deleting the illustrative examples currently available to assist in making this determination, without providing any replacement illustrative guidance, will hinder the Boards from being able to achieve their stated objectives. That is, this analysis will become more judgmental and subject to further differences in application to similar transactions than already exists.

Consideration payable to a customer

There are currently more than 25 examples in ASC 605-50, *Revenue Recognition - Customer Payments and Incentives*, that illustrate the guidance on accounting for consideration payable to a customer, including the treatment for "negative" revenue and slotting fees. IFRIC 13 *Customer Loyalty Payments* also provides two examples in relation to principles in the interpretation. However, the revised ED includes only one example on the treatment of consideration payable to a customer (Example 10).

Similar to our comments on the evaluation of principal versus agent considerations, this is another area where application of the guidance can be highly judgmental. Currently, preparers use the illustrative examples within the existing guidance to (1) determine whether consideration payable to a customer should be accounted for as a reduction of the transaction price or in the same manner in which it accounts for other purchases from suppliers and (2) ensure that the conclusion is consistent with the stated principles in the guidance. As the Boards do not appear to be changing the underlying principles within this aspect of the standard, we believe these examples would continue to be helpful for purposes of determining whether an entity is receiving an identifiable benefit from its customer for purposes of assessing the appropriate accounting for the transaction.

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Similarly, as stated in our comment letter on the revised ED, we believe additional implementation guidance is necessary to illustrate whether “negative” revenue from a customer would be presented as an expense, consistent with current US GAAP. This is an area of current divergence as IFRS does not currently provide specific guidance on the presentation of “negative” revenue.

Bill-and-hold arrangements

Existing US GAAP and IFRS provide similar, but not identical, guidance on evaluating the substance of bill-and-hold arrangements. Experience shows that this is an area requiring significant judgment to determine whether the transaction represents a sale. However, we are concerned that the guidance included in the proposed ED will not make these judgments easier, and in fact, will likely make them more complex.

While the proposal includes criteria that must be met for a customer to have obtained control of a product in a bill-and-hold arrangement, these criteria can be broadly interpreted. We believe implementation guidance is necessary to clarify the Boards’ intent.

For example, one criterion within the ED that must be met in order to recognize revenue on a bill-and-hold transaction is that the reason for the bill-and-hold arrangement must be substantive. However, it is not clear how an entity would determine whether the rationale for the bill-and-hold arrangement is substantive. That is, should the determination be made from the customer’s perspective, the vendor’s perspective or both?

In another example, the guidance in US Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) Topic 13 requires that the buyer “must” request the bill-and-hold arrangement. Conversely, Illustrative Example 1 of IAS 18 presumes that the bill-and-hold arrangement was made at the customer’s request but does not explicitly require it. The phrase in paragraph IG51 and B51 of the ED that “a customer *may* request an entity to enter into such a contract” (emphasis added) is likely a significant change from current US practice, although it is unclear if that was the Boards’ intention.

We also observe that the guidance in SAB Topic 13 is based on certain Accounting and Auditing Enforcement Releases (specifically AAER Nos. 108, 817 and 971) which were actions by the Commission, as opposed to the staff. We encourage the Boards to reconcile these differences with the SEC and for US domestic registrants and foreign private issuers to be provided clear guidance about the ongoing effect of those AAERs.

Recognizing revenue over time or a point in time

Determining whether control transfers over time or at a point in time is expected to be an area of significant judgment, as is the method an entity might use to measure progress for performance obligations satisfied over time. These aspects of the model were discussed and clarified during the Boards’ recent redeliberations, but it is unclear what implementation guidance, if any, will be incorporated into a final standard.

For example, revenue recognition for real estate arrangements is often complex and significant judgment is required to determine the appropriate timing and pattern of revenue recognition. This has led to the development of different sources of guidance within

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US GAAP, including ASC 360-20, *Retail Estate Sales*, and ASC 976-605, *Real Estate - Retail Land - Revenue Recognition*, and ASC 978-605, *Real Estate - Time-sharing Activities - Revenue Recognition* and within IFRS, including IFRIC 15 *Agreements for the Construction of Real Estate*. However, all of the revenue-related guidance in these US GAAP Subtopics and this IFRS interpretation will be superseded by a final standard. The revised ED includes only two examples relevant to the real estate industry, including (1) Example 5 which illustrates how an entity should identify separate performance obligations when it enters into a contract to design and build a hospital and (2) Example 7 which illustrates whether an asset has alternative use.

Respondents to the revised ED from the real estate industry, including the time-share sector, also requested additional implementation guidance on whether the separate performance obligations in their arrangements would meet the criteria for satisfaction (and therefore, recognition of revenue) over time.

Another example relates to entities in the software industry that requested additional implementation guidance on whether the consideration received for the sale of a license should be recognized over time or at a point in time. Under current US GAAP, consideration for certain types of licenses is recognized ratably over the license term (i.e., under subscription accounting). We understand that the Boards are currently redeliberating this aspect of the model. Once a decision is reached, we encourage the Boards to provide additional implementation guidance - not only for software licenses, but for other licenses as well - in order for entities to consistently reflect the economics of the arrangement and ensure comparability between entities that enter into similar licensing arrangements.

Also, specifically under current US GAAP, automotive manufacturers are not precluded from recognizing revenue at the time the vehicle is transferred to a dealer if certain conditions are met - even when the manufacturer has an obligation to repurchase the vehicle from the dealer in order for the manufacturer to lease the vehicle to a qualified customer through the manufacturer's captive finance company. This guidance, which is primarily codified in ASC 605-15, *Revenue Recognition - Products*, will be superseded by a final standard. Similar, but less prescriptive, guidance exists in Illustrative Example 5 of IAS 18.

While we don't believe the Boards' intent is to change the timing of revenue recognition for vehicle sales to the dealer, we believe that the removal of this guidance makes the determination less clear. We believe additional implementation guidance for this type of arrangement would clarify the Boards' intent and ensure comparability between entities with similar arrangements.

Identifying separate performance obligations

Identifying performance obligations is a critical component of the proposal and we believe more guidance is needed to help entities identify separate performance obligations. While the Boards discussed and refined the guidance for identifying separate performance obligations as part of their recent redeliberations, it is unclear what implementation guidance, if any, will be incorporated into a final standard. We believe that without additional implementation guidance, significant diversity in practice will likely develop.

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For example, time-shares are often sold in intervals (a specific unit for a specific week during the year) or in the form of points that a customer can redeem for occupancy at various sites. Under current practice in US GAAP, revenue is recognized up-front when certain criteria in ASC 360-20 and ASC 978-605, *Real Estate - Time-sharing Activities - Revenue Recognition*, are met. This guidance will be superseded by a final standard and it is unclear how the proposal would affect time-share accounting. That is, would the distinct good or service (and separate performance obligation) in these transactions be a specific time-sharing unit or an allotment of points in the contract that the customer is able to use, sell or exchange, or the customer's right to use the time-share each year? The conclusion would likely affect the pattern of transfer (that is, whether the goods and services are delivered at a point in time or over time).

As another example, ASC 985-605, *Software - Revenue Recognition*, currently provides more than 200 paragraphs of implementation guidance, including 13 comprehensive examples, to illustrate how the guidance in this Subtopic should be applied to software arrangements. IAS 18 also includes an illustrative example related to software. However, IFRS does not include any further guidance and software entities preparing financial statements in accordance with IFRS often analogize to ASC 985-605 in accordance with IAS 8.

We are concerned that entities in the software industry (and other industries with similar issues) will have difficulty applying the principles in the revised ED consistently. The guidance in ASC 985-605 was developed when the software industry previously struggled to apply general revenue recognition guidance consistently. The revised ED includes only one example relevant to entities in the software industry (Example 4) and illustrates how an entity should identify separate performance obligations when an entity is providing a software license and consulting services.

Respondents to the revised ED from the software industry have requested additional implementation guidance on a number of topics, including guidance on whether post-contract customer support (PCS), which is defined solely in ASC 985-605 and typically includes telephone support, programming "bug" fixes and unspecified upgrades, would be considered "distinct" and accounted for as separate performance obligations.

Barter transactions

ASC 605-20, *Revenue Recognition - Services*, specifically paragraphs 25-14 through 25-18, and SIC-31 *Revenue-Barter Transactions Involving Advertising Services* provide specific guidance on barter advertising transactions.

Because these paragraphs in US GAAP and this IFRS interpretation will be superseded and similar guidance is not currently included in the ED, we are concerned that an opportunity for entities to overstate revenue by recognizing revenue and associated costs on barter advertising transactions may again exist. We do not believe paragraph 14(a) of the ED, which would require that a contract has commercial substance, provides sufficient guidance to result in consistent and appropriate conclusions. Therefore, we believe additional implementation guidance should be included to address these transactions. For example, the current guidance in ASC 605-20-25-14 through 25-17 could be included as an example of how commercial substance can be assessed in advertising barter transactions.