



SAS Quadra 05. Bloco J. CFC

Brasília, Distrito Federal - Brazil

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March 12, 2012

**International Accounting Standards Board**

30 Cannon Street

London EC4M 6XH

United Kingdom

**Financial Accounting Standards Board**

401 Merritt 7, PO Box 5116

Norwalk, CT

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**RE: Exposure Draft (ED/2011/6) on Revenue from Contracts with Customers**

Dear Sir/Madam,

The "Comitê de Pronunciamentos Contábeis" - CPC<sup>1</sup> welcomes the opportunity to comment on the second Exposure Draft named Revenue from Contracts with Customers.

We are a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies.

This response summarizes the views of our members, which may be supported by the opinions of external parties, sent to us for analysis and to enhance the discussion on the subject matter. We have also made efforts to encourage other external parties to send comments directly to the IASB.

We overall support the proposal for convergence of the revenue recognition criteria between IFRS and US GAAP. However, we would appreciate the Boards announcing the reasons, risks and benefits

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<sup>1</sup> The Brazilian Accounting Pronouncements Committee (CPC) is a standard setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).



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for migration from the previous standards (IAS 11 – Construction Contracts and IAS 18 - Revenue) to this new model proposed in the Exposure Draft, which apparently contains some unclear and less objective criteria, e.g. the criterion set forth in paragraph 35(b), which approaches revenue recognition over time. In this specific case, we propose in our response that the Boards incorporate the whole paragraph 35(b) as a sub item to paragraph 35(a), serving as an illustration of the definition of transfer of control over time. In addition, we propose that the concepts explained in Basis for Conclusion 90-103 be directly included in paragraph 35 to settle any doubts on the implementation by standard enforcers, making it clearer, mainly as regards revenue recognition over time for certain industries, such as of real estate development.

Furthermore, we would appreciate the Boards better defining the application of the concept of transfer of control of rendering of services. The definition of control, according to paragraph 32, is the ability to use and obtain substantially all benefits of the asset, as well as prevent other entities from directing the use of or obtaining benefits from the asset. In case of a service, the indicators of transfer of control are even more related to the entity's ability to obtain benefits from the services provided and, eventually exposure to their risks, so that the previous revenue recognition model contained in IAS 18 appears to be more applicable in this case, to the detriment of the current transfer of control model; in other words, it is not clear in the ED why a change from the "risks and rewards" concept in IAS 18 is being substituted by the "control" concept if at the end the control concept drives preparers back to the risks and rewards approach – with all due respect, it seems that substantial efforts are being undertaken to bring stakeholders back to the starting point, and clarification is requested in the Basis for Conclusions or other appropriate section as to why the change is being proposed and why it is not "return to the past". We also believe that, even if the control concept is held for sale of services in the final pronouncement, the Boards might also consider including the concept of recognition of revenue by activities for services and long-term contracts, as BC 91 considered it by reference to paragraph 22 of AICPA Statement of Position 81-1. The concept of recognition of revenue based on activity appears to be more understandable and more easily applicable for transactions involving services and long-term contracts.

The CPC believes that the Boards should consider increasing the use of practical and more complex examples for a better interpretation of the requirements set forth in the standard, e.g. example 7, which deals with an alternative use of a real estate unit and might be expanded to demonstrate the factors under analysis to comply with the criterion set forth in paragraph 35 (b) (ii).

Another concept CPC believes worth further analysis by the Boards is that concerning the need to set up a liability for an onerous obligation for each performance obligation, instead of carrying out



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such analysis at contract level. In connection with this requirement, an overall positive margin contract, yet strategically containing some negative margin performance obligations, must inappropriately set up a liability. Another aspect linked to this analysis concerns the one-year deadline to comply with the performance obligation set by the Boards to require the analysis of the onerous contract. CPC understands that setting a fixed deadline for this analysis is not appropriate. Instead, such analysis should be carried out for all contracts having onerous performance obligations, irrespective of duration.

CPC also points out the one-year deadline to reflect the time value of the money. We believe that circumstantial factors, e.g. inflation index or interest rate in a jurisdiction, should be taken into consideration when assessing the need to calculate the present value adjustment in maybe shorter deadlines.

The CPC thanks for the opportunity to welcome some a IASB Board member and staff of IASB and of FASB on their visit to Brazil in March 2012, precisely in an outreach to discuss this specific ED. Other issues that may be identified in the discussions in that outreach may lead to additional observations not set out in this comment letter.

If you have any questions about our comments, please contact Mr. Idésio da Silva Coelho Júnior (operacoes@cpc.org.br), CPC's vice-coordinator of International Affairs, and coordinator of a working group constituted to study any proposal-stage literature issued by the IASB.

Yours sincerely,

**Edison Arisa Pereira**  
Technical Coordinator  
Brazilian Accounting Standards Board (CPC)

### Recognition of revenue

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#### Question 1

Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognizes revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

#### Comments on Question 1

We agree with the proposed revenue recognition over time, provided that the control is transferred to the customer over time. However, we have the following comments in respect to paragraph 35(b):

- a) We understand that paragraph 35(b) would be more effective as a sub-item of paragraph 35(a), serving as an illustration of the definition of transfer of control over time, instead of being set as separate criteria. Such proposal aims to avoid different interpretations by the applicants, making the concept clearer and objective, and focusing on transfer the control, which we believe is the key aspect to be analyzed in order to conclude whether revenue should be recognized over time or at a point in time.
- b) We suggest replacing the wording of paragraph 35(b)(ii) with that of BC97, which is clearer and more objective, and give examples on the application of the criterion.
- c) We believe that paragraph 36 states the entity shall assess whether an asset may be alternatively used, considering whether it is contractually prevented from transferring the asset or practically to another customer and whether significant costs are not incurred for such transfer. These criteria may entail the risk of easy manipulation to fit into the rule of revenue recognition over time, whereby contracts are structured for products and services earmarked for specific customers, when in fact they might be easily transferred to third parties without involving high costs, since the original sale contract would be terminated. We suggest that the Boards better detail this requirement, including, for example, the condition that the contract should have economic substance and reasoning.
- d) Also, we understand that the current wording of paragraph 35 b) ii) as applied to real estate development entities in Brazil, may give rise to doubts about its application. We suggest that the Boards provide a clearer and more objective criterion in the final pronouncement, including guidance or example of application (expansion of illustrative example 7). In Brazil, the control over an asset under construction may be transferred to the acquirers through a legal proceeding in specific cases, e.g. failure in performance or bankruptcy of the original developer. Considering this uniqueness, it would be possible to imply that the succeeding developer would access the asset under construction and therefore would not need to re-perform the work until then carried out by the original developer, and eventually revenue may be recognized over time.

- d) We also believe that, even if the control concept is held for sale of services in the final pronouncement, the Boards might consider including the revenue recognition concept based on activity for service and long-term contracts, as similarly considered by BC 91 through mention of paragraph 22 of AICPA Statement of Position 81-1. The activity concept seems to be easily understandable and applicable to contract involving services and long-term contracts.

### Question 2

Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

### Comments on Question 2

Although we agreed with the first proposal for treatment of the customer's credit risk contained in the ED issued in 2010, we believe that the current model is also an appropriate alternative, once the concept proposed in the revised ED is not conflicting with the previous one, which classified the provision for credit risk, since both suggest that the value should not be classified in the expenses group, but in the net sales revenue group.

### Question 3

Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognizes to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognize for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

### Comments on Question 3

We agree that there should be a limitation for variable consideration recognition in case of a satisfied performance obligation, in view of past experience, duly adjusted by the situations observable and applicable to the contract under analysis. We suggest that the Boards consider including specific guidance so that the receivables from variable consideration are timely revised as to their realization.

Although we agree with the concept set out in paragraph 85, we do not understand the reason why the Boards emphasized the specific treatment to be given to the intellectual property licenses. In light of the concepts set forth in paragraphs 81 to 84, it seems to be clear the treatment that should be given in these cases and, therefore, we suggest that the Boards consider removing paragraph 85 from the final pronouncement, since it may be incorrectly inferred that it applies only to this type of transaction.

### **Question 4**

For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognize a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

### **Comments on Question 4**

While the model proposed in the ED on revenue recognition is based on allocation of selling price to each performance obligation, the criterion to recognize an onerous liability at the level of each obligation may be inappropriate in certain circumstances. For example, if an entity strategically sets the price for a given obligation below the transaction price, but can strategically recover this loss in other obligations of the same contract, it does not seem reasonable to recognize an onerous liability for such contract, provided that the obligations may be combined.

Also, we believe that the one-year deadline set to satisfy a performance obligation might not be appropriate in all circumstances. If there is, for example, an onerous liability in a contract executed in November to be effective for 11 months, we believe it would be relevant to recognize a liability of this transaction in the financial statement for the fiscal year ended December.

Accordingly, we suggest that the Boards set no minimum limit so that the financial statements preparer can consider the period for assessment of the onerous liabilities which are significant for their needs of financial information preparation (monthly, bi-monthly, quarterly, semi-annually or, at maximum at each fiscal year end).

### Question 5

The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports. The disclosures that would be required (if material) are:

- The disaggregation of revenue (paragraphs 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- An analysis of the entity's remaining performance obligations (paragraphs 119–121)
- Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
- A tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.

### Comments on Question 5

We agree with the proposal that a financial statement user has as many pieces of relevant information as possible available for the analysis of the nature, amount, term and uncertainty as regards revenue and cash flows from contracts with customers, however we believe that the cost benefit to obtain such information should also be taken into consideration.

We believe that the proposal set out in IAS 34 – Interim Financial Reporting and ASC 270 lies in that the objective interim information supplements the information disclosed at year end and reports on new and significant contracts won and on significant changes in judgment on contracts, e.g. variation of estimates, involving the amounts of variable revenues or performance obligations not satisfied. Accordingly, one rather feels that the disclosures required by paragraphs 117, 128, 119-121 and 122-123 would be out of the interim financial statement concept, given the complexity and related costs.

Similarly, interim information about publicly-help companies in Brazil should be filed no later than 45 days as from the quarter end date, which might impair the disclosure of such complex information.

As regards the requirement set out in paragraph 114 on disaggregation of revenue, there is apparently an overlapping between IFRS 8 and ASC 280 as segments are concerned. We suggest that the Boards analyze and reconcile the disclosures required in the pronouncements on segments and revenue to avoid disclosures in duplicate.

Accordingly, we understand that paragraphs 109-130 of the ED tend to be treated by the parties who apply them as a standard list of obligatory disclosures, which may lead entities to no longer evaluate how significant the disclosure is. For example, a retail chain may not have onerous contracts. Meeting the IFRS core purpose of requiring disclosures based on principles, discussing the idea of summarizing the disclosures included in the financial statements, the Boards might consider including a clear mention that the entities should evaluate the disclosures significant for their real economic scenario.

While this question concerns the required disclosure of interim financial statements, we point out that the disclosure rules set forth in the ED, even if applied to the annual financial statements, are apparently excessive, since in most of cases the costs to obtain all required information are high, with only a few benefits to the information users. We believe that the Boards should require the applying parties to use the relevance and faithful representation principles to guide their appropriate disclosure. Finally, we emphasize that in Brazil the annual financial statements of the publicly-held entities and of unlisted corporations should be published in wide circulation newspapers, which is a high cost for the entities.

### **Question 6**

For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognize the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognize upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

### **Comments on Question 6**

We agree that the revenue recognition model should also be applied to the sale of non-financial assets (with the related considerations about contractual definition, invoiced price, transfer of control), but we understand that the specific standards relating to fixed assets, for instance, should be addressed by specific pronouncements which should be revised to include the concepts set forth in this ED.

### OTHER MATTERS

We have taken the liberty of requesting the Boards to analyze and comment also other aspects not included in the questions asked in the ED circulated by you:

1) Definition of revenue included in Glossary A:

Revenue is defined in the ED as that “arising in the course of an entity’s ordinary activities.”

In its turn, income is defined as “increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.”

Revenue is defined in IAS 18 as “the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.”

Although the definition of revenue in the ED is in line with the conceptual structure, one rather feels that revenue is the net, and not gross, increase in the entity’s economic benefits, as defined in IAS 18. We suggest that the Boards revise this terminology for semantic purposes, maintaining the definition of the IAS 18 mentioned above.

2) Paragraph 10:

Paragraph 10 excludes from the ED scope the contracts not entered with a customer, e.g. an collaborator or partner. We suggest that the Boards define, in these latter cases, what is the revenue recognition criterion to be adopted, or clearly define that, if the transaction conditions are similar to those of an arm’s length transaction, the pronouncement itself would be applicable.

3) Paragraph 35 (b) (iii):

It is mentioned that “the entity has a right to payment for performance”. In some jurisdictions, including Brazil, the term “payment” is interpreted as an obligation to pay, thus better understood as “receipt” in this specific situation. We suggest that the Boards revise this terminology so that as many jurisdictions as possible clearly understand the matter.

### 4) Paragraph 60:

The paragraph mentions that “as a practical expedient, an entity need not adjust the promised amount of consideration to reflect the time value of money if the entity expects at contract inception that the period between payment by the customer of all or substantially all of the promised consideration and the transfer of the promised goods or services to the customer will be one year or less.” We suggest that the Boards consider revising this practical expedient of setting one year for requiring the adjustment of time value of money, similar to IAS 37- Provisions, Contingent Liabilities and Contingent Assets, which does not set a time to recognize a liability, or IAS 11 itself, as onerous contracts are concerned. In some jurisdictions with high inflation indexes and eventual high interest rates, this period may not be significant from the economic viewpoint. Although the effect of time value of money may not significantly affect the entity’s equity, there are often significant effects on captions or units of account such as financial results and revenues in the income statement and accordingly certain key performance indicators ( e.g.: operating income) currently used by preparers, analysts and investors .

### 5) Paragraph 63:

The paragraph mentions that, if the entity is not in a position to reasonably estimate the fair value of non-monetary considerations, the entity should indirectly estimate the consideration by reference to the individual sale price of the products or services used in exchange. We suggest that the Boards better define the expression “reasonably estimated” to avoid inconsistencies in the application of this concept or eliminate the term “reasonably” from the final pronouncement, since the estimate concept is already clear for those applying the standard.

### 6) Paragraph 94

Some applicants may challenge the capitalization of incremental costs to obtain a contract, on the grounds that such costs should be immediately expensed, since they do not comply with the concepts of IAS 38 – Intangible assets, or similarly to the procedures adopted for costs of transaction under IFRS 3 – Business Combinations. If the Boards decide to keep the proposal included in the ED, we suggest giving more examples of situations in which incremental costs can be capitalized. The example given in the ED on commissions on sales may lead to believe that only incremental costs linked to obtained contracts can be capitalized, however not maintaining the costs being incurred to obtain a contract. Of course, we understand that costs incurred or being incurred with contracts not obtained or whose likelihood of favorable outcome is low must be immediately expensed.

7) Reference to the title of ED – Revenue from Contracts with Customers

Although it is intuitive why the Boards titled the pronouncement “Revenue from Contracts with Customers”, we suggest that the Board clearly include in the final pronouncement the reason for having renamed the pronouncement “Revenue from Contracts with Customers”, instead of keeping the IAS 18 title “Revenue” or the first EDs title “Revenue recognition”.

We consider relevant to be explored by the Boards in a final document or by any other appropriate means the reasons for this change in the title of the revised ED: it is not clear which is the message behind the change in the name of the first ED, “Revenue Recognition”, to “Revenue from Contracts with Customers”; it is certainly not a trivial modification and we believe that the Boards wanted to convey a message to stakeholders, but we fail to understand which it is and would greatly appreciate it is clarified by the Boards for the sake of sound implementation of the future standard.