

13 March 2012

International Accounting Standards Board

30 Cannon Street
London EC4M 6XH
United Kingdom

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

Dear Board Members,

The “Group of Latin American Accounting Standard Setters” – GLASS¹ welcomes the opportunity to comment on the Exposure Draft Amendment - Revenue from Contracts with Customers (the “2011 ED”).

This response summarizes the views of our country-members, in accordance with the following due process.

Due-process

The discussions in regard to the Exposure Draft Amendment – Revenue from Contracts with Customers were held within a specified Technical Working Group (TWG) created on October 26, 2011. All country-members had the opportunity to designate at least one member to constitute this TWG, and the following countries did so: Brazil (coordinator of this TWG), Venezuela, Uruguay, Ecuador, Bolivia, Argentina and Mexico.

Individually, all TWG members, except Bolivia, summarized the answers from their respective countries. At a second stage, the answers presented in every country’s summaries were compared and discussed.

Overall comments

We support the proposal for convergence of the revenue recognition criteria between IFRS and USGAAP. Concerning the criteria for revenue recognition over time, 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 paragraphs 90 to 103 of the Basis for Conclusions be directly included in paragraph 35 to clarify any doubts upon implementation, making it clearer, mainly as regards revenue recognition over time for certain industries, such as real estate development.

Furthermore, we would appreciate the Boards better defining the application of the concept of transfer of control related to the rendering of services. The definition of control, according to paragraph 32, is “the ability to direct the use of and obtain substantially all of the remaining benefits from the asset”, as well as “the ability to prevent other entities from directing the use of or obtaining benefits from an asset”. In the 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, such that the previous revenue recognition model contained in IAS 18 appears clearer in this case, as opposed to the current transfer of control model; in

¹ The general objective of the Group of Latin American Accounting Standard Setters (GLASS) is to present technical contributions in respect to all documents issued by the IASB. Therefore, GLASS aims to have a single voice before the IASB. GLASS is constituted by: Brazil (Chairman), Argentina (Vice Chairman), Chile (Board), Mexico (Board), Uruguay (Board), Venezuela (Board), Bolivia, Colombia, Ecuador, Panama, Paraguay and Peru.



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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 in the end the control concept brings preparers back to the risks and rewards approach. We also believe that, even if the control concept is retained for the sale of services in the final pronouncement, the Boards might also consider including the concept of percentage of completion accounting for long-term services and contracts, just as paragraph BC91 considered it by reference to paragraph 22 of AICPA Statement of Position 81-1. The concept of percentage of completion accounting appears to be more understandable and more easily applicable for transactions involving long-term services and contracts.

GLASS believes that the Boards should consider increasing the use of more practical and expanded 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 GLASS believes merits further analysis by the Boards is that concerning the need to set up a liability for an onerous obligation for each individual performance obligation, instead of carrying out such analysis at the contract level. In connection with this requirement, an overall profitable contract, yet strategically containing some negative margin performance obligations, must inappropriately recognize a liability. Another aspect linked to this analysis concerns the one-year practical expedient to comply with the performance obligation established by the Boards to require recognition of an onerous performance obligation. GLASS would appreciate clarification as to whether it is acceptable to recognize a liability for an onerous performance obligation that an entity expects at contract inception to satisfy over a period of time of less than one year, since we believe that such analysis should be carried out for all contracts having material onerous performance obligations, irrespective of their duration.

GLASS also points out that with respect to the one-year practical expedient to reflect the time value of the money, we believe that circumstantial factors, e.g., amounts involved in the transaction, interest rates, term of the transaction, and relevance of the transaction in relation to equity and year results should also be taken into consideration by the entity when assessing the need to calculate the present value adjustment even when the period between payment by the customer and the transfer of the promised goods or services is less than one year. Thus, we suggest that the Boards eliminate this practical expedient and replace it with a requirement to adjust the promised amount of consideration to reflect the time value of money when the effect is deemed to be significant, regardless of the period of time.

If you have any questions about our comments, please contact glenif@glenif.org.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Juarez Domingues Carneiro", written over a circular stamp or seal.

Juarez Domingues Carneiro
Chairman

Group of Latin American Accounting Standard Setters (GLASS)



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GLASS' Comment letter on the IASB Exposure Draft Revenue from Contracts with Customers

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?”

We agree with the revised recommendations to determine when an entity satisfies a performance obligation over time and therefore recognizes revenue over time. The "continuous transfer of assets or services" concept set forth in the 2010 ED was vague and would be very difficult to put it into practice. We agree with the basic principle that an asset created or enhanced must be controlled by the customer for a performance obligation to be satisfied over time. Nonetheless, as indicated in paragraph BC92 of ED 2011, it frequently may not be clear if there is a continuous transfer of control. The second category added to ED 2011 concerning the alternative use for the entity properly addresses this issue.

However, we have some specific comments, as set out below:

- a) We believe 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 more objective by focusing on the transfer the control, which we believe is the key aspect to be analyzed to determine whether revenue should be recognized over time or at a point in time.
- b) The wording of paragraphs 35 and 36 could be improved to accurately reflect the contents of Basis for Conclusions paragraphs BC85-103, which is clearer in the description of the requirements for revenue recognition over time. BC97, for example, clearly illustrates when an entity does not need to re-perform the work carried out on a given date, whilst paragraph 35(b)(ii) may give rise to questions or doubts of financial statement preparers. The wording suggested for paragraph 35, expanded (underscored) in connection with the Basis for Conclusions, reads as follows:



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“35 An entity transfer the control over an asset or services over time and, hence, satisfies a performance obligation, and recognizes over time if at least one of the following two criteria is met:

(a) the entity’s performance creates or expands an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (e.g. a performance obligation is satisfied over time in a number of construction contracts, as the customer controls the work in progress – either tangible or intangible – in connection with the entity performance). An entity shall apply the requirements on control in paragraphs 31-33 and paragraph 37 to determine whether the customer controls an asset as it is created or enhanced; or

(b) the entity’s performance does not create an asset with an alternative use for the entity (see paragraph 36) (if the entity creates an asset with alternative use, the customer may not control the asset) and, at least, one of the following criteria is met:

(i) the customer is simultaneously receives and consumes the benefits from the entity performance as the entity performs. In some cases in which an entity performance does not create an asset with alternative use for the entity, the customer is simultaneously granted a benefit and uses it as the entity realizes it. For example, an entity which commits itself to process transactions on behalf of one of its customers, the processing of each operation by the entity does not create an asset of alternative use for the entity, and at the same time the customer is granted a benefit and uses it when the transaction is processed.

(ii) another entity would not need to substantially re-perform the work the entity has completed to date, if that other entity were to fulfill the remaining obligation to the customer. This arises from the fact that the customers may already have been fully benefited by the entity performance to date (e.g. receive the assets or services) if another entity may, in its turn, satisfy only the remaining obligation involving the customer without substantially resuming the work completed to date. In evaluating this criterion, the entity shall presume that another entity fulfilling the remainder of the contract would not have the benefit of any asset (for example, work in progress) presently controlled by the entity. It would be in a position to do so only if the customer controls the work in progress. In addition, an entity shall disregard potential limitations (contractual or practical) that would prevent it from transferring a remaining performance obligation to another entity.

(iii) the entity has a right to payment for performance completed to date and it expects to fulfill the contract as promised (unless it expected to perform the contract as promised, case in which the entity cannot be entitled to payment for the performance to date). If an entity’s performance to date does not create an asset with alternative use for the entity (for example, an asset which could be



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easily intended for another customer) and the customer is required to pay for the recognition to date, then it is deemed that the customer has already received for this performance. The right to payment for performance completed to date does not need to be for a fixed amount. However, the entity must be entitled to an amount that is intended to, at least, compensate the entity for performance completed to date, even if the customer can terminate the contract for reasons other than for the entity's failure to perform as promised. Compensation for performance completed to date includes payment that approximates the selling price of goods or services transferred to date (for example, recovery of entity's costs plus a reasonable profit margin), rather than compensation only for the entity's possible loss of profit if the contract is terminated. The entity is not entitled to payment for performance to date if the customer provides the entity with a sole compensation for a loss of benefits arising from the contract termination by the customer and from the significant costs incurred by the entity for re-performance of work so that it is in a position to redirect the asset to another customer."

- c) The section of illustrative examples of the Draft Standard might include a second example more specific than Example 7 for its use in the framework of real properties in jurisdictions where more complex contractual conditions exist, and paragraphs 35(a), 35(b)(i) and 35(b)(iii) do not apply, obliging the entity to focus on the analysis of paragraph 35(b)(ii).

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?"

Notwithstanding the fact that 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 2011 ED is not conflicting with the previous one, since both suggest that the expected loss amount should not be classified in the expenses group, but in the net sales revenue group.

Although we agree that the estimated initial loss should be recorded on the line adjacent to the revenue line item, the majority of us believe that losses identified after the inception date should be recorded in operating expenses, since it does not seem to be appropriate to report such losses as a line item adjacent to current period revenues.



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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?”

We agree with the constraint proposed for revenue recognition in accordance with paragraph 81, despite the fact that it is a matter of management judgment to determine whether or not the entity’s past experience is predictive of the future behavior of customers or the expected output of the related variables. When material, appropriate disclosure of management’s judgment should be made.

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?”

We do not agree with the proposed objective of the onerous performance obligation test for two reasons, namely:

Firstly, we do not believe that the onerous test should be made for each individual performance obligation of a single contract with a customer. This may lead to overlooking the economic substance on how the price of the individual elements was established within the whole contract. Consider the following example, assuming the seller can demonstrate that the license and maintenance services are separate performance obligations as defined in the 2011 ED:



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	Standalone prices			Allocation per 2011 ED		
	Product license	Maintenance services	Bundled arrangement	Product license	Maintenance services	Total
Selling price	\$100,000	\$100,000	\$160,000	\$80,000	\$80,000	\$160,000
Cost	35,000	85,000	120,000	35,000	85,000	120,000
Margin	\$65,000	\$15,000	\$40,000	\$55,000	(\$5,000)	\$40,000
Margin %	65%	15%	25%	69%	(6%)	25%

Unless the entity can allocate the discount entirely to the product license performance obligation pursuant to the criteria of paragraph 75 of the 2011 ED, which often may not be possible, as the transaction price allocation method set forth in ED 2011 does not consider the economic substance of how the price of the individual elements was established in the bundled arrangement, there is an apparent loss on the maintenance service performance obligation that would require recognizing an onerous contract liability at the inception of the contract. However, we do not believe that an onerous contract liability necessarily exists.

We believe that a more appropriate approach of transaction price allocation would be to consider the entire contract as a separate product and maintain the profit margin of the bundled arrangement for each performance obligation, as follows:

	Standalone prices			Proposed revised allocation		
	Product license	Maintenance services	Bundled arrangement	Product license	Maintenance services	Total
Selling price	\$100,000	\$100,000	\$160,000	\$47,000	\$113,000	\$160,000
Cost	35,000	85,000	120,000	35,000	85,000	120,000
Margin	\$65,000	\$15,000	\$40,000	\$12,000	\$28,000	\$40,000
Margin %	65%	15%	25%	25%	25%	25%

We wonder if the selling price of the maintenance services should not be capped, since as you can see in the example provided above, the transaction price allocated to such services is greater than the standalone selling price due to the bundled margin being greater than the standalone margin.

In summary, we agree that a provision for onerous contracts should be recognized whenever the sale contract has an overall negative margin; however, we do not necessarily agree with a



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provision being set up whenever a contract has an overall positive margin but contains performance obligations with negative margin. In the latter case, we believe that it is in fact a problem involving the criteria for allocation of individual prices of each performance obligation, which might be resolved if the model proposed in the preceding example is approved. This issue is specifically addressed in BC186 of the 2011 ED, including consideration of a profit margin approach. However, we do not believe the exceptions discussed in paragraphs 75 and 76 of the 2011 ED are sufficient.

Secondly, we do not believe that an onerous performance obligation should necessarily be a performance obligation that the entity expects to satisfy over a time longer than one year. We would appreciate clarification as to whether it is acceptable to recognize a liability for an onerous performance obligation that an entity expects at contract inception to satisfy over a period of time of less than one year, since we believe that such analysis should be carried out for all contracts having material onerous performance obligations, irrespective of their duration. Our proposed alternative methodology to allocate the transaction price described above appropriately removes the unintended consequences for many contracts.

Thus, while we agree that an onerous performance obligation test should be applied to performance obligations satisfied by an entity over time, we believe that the economic substance of how the price of individual elements determined in a package should be taken into consideration. Furthermore, we are not convinced that the onerous test should only be applied to performance obligations an entity expects to satisfy over a time longer than one year.

Conceptually (regardless of the proposed example), we understand that the allocation of the transaction price must be done in a consistent manner, regardless of the final amount of any of the components.



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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)**

*** In the IASB exposure draft, see paragraph D19 in Appendix D.**

- **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.”

We agree with the proposal that a financial statement user have as much information as possible for the analysis of the nature, amount, term and uncertainty regarding 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.

In general, we agree with the requirements of paragraph 113, which is the disclosure of disaggregation of revenue and the reconciliation of contract assets and liabilities, including the provisions of onerous contracts. Since revenue is one of the most important measures in financial information, one assumes that the required information is available to management, thus not representing a significant additional cost to provide the required information.



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We understand that paragraphs 109 to 130 of the ED are 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 principle 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.

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?”

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 ownership), 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.



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ADDITIONAL CONCERNS

We have taken the liberty of requesting the Boards to analyze also other aspects not included in the questions to the following respondents:

1) Definition of revenue included in Glossary A:

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

In 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 framework, we believe that revenue is the gross, and not net, increase in the entity’s economic benefits, as defined in IAS 18. We suggest that the Boards revise this terminology for semantic purposes.

2) Paragraph 10:

Paragraph 10 excludes from the ED scope the contracts not entered with a customer, e.g. an associated professional or partner. We suggest that the Boards define, in these latter cases, the revenue recognition criteria to be applied.

3) Paragraph 60:

This paragraph includes a practical expedient regarding the need for adjustment of the promised amount of consideration to reflect the time value of money. This paragraph states that no adjustment is necessary 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. In some instances, depending on the amounts involved, interest rates, terms of the transactions, and relevance of the transactions in relation to equity and annual results, the one-year practical expedient could result in the failure to recognize significant required adjustments. We believe this practical expedient should be eliminated and replaced by a requirement to adjust the promised amount of consideration to reflect the time value of money when the effect is deemed to be significant.



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4) 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 in the future.

5) Paragraphs 94-97:

It would be very helpful if the IASB added an illustrative example presenting a situation whether a cost is not qualified for being accounted for as a “cost of obtaining”, but as an expense (paragraph 96).

6) Illustrative Examples

By and large, the illustrative examples do a good job in explaining the proposals and put them into practice. However, we believe that the obligatory accounting entries, as set out in examples 9, 17 and 18, would be very useful in other examples, such as 19, 20, 24 y 25, to ensure the guidance is correctly applied.

** End of the document. **