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19 June 2009

Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir David:

re: Comments on Discussion Paper
"Preliminary Views on Revenue Recognition in Contracts with Customers"

The Corporate Accounting Committee (CAC) of the Securities Analysts Association of Japan (SAAJ) is pleased to comment on the joint discussion paper by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB), (collectively called 'the Boards'), "*Preliminary Views on Revenue Recognition in Contracts with Customers*". The SAAJ is a not-for-profit organization providing investment education and examination programs for securities analysts. Its certified members exceed 23,000. The CAC is a standing committee of the SAAJ composed of 13 members, most of whom are users including equity and credit analysts, and portfolio managers, while a few others are academicians and public accountants. Before drafting this comment letter, the SAAJ sponsored a study session on the discussion paper, inviting two ASBJ (the Accounting Standards Board of Japan) staff as lecturers. Some 146 certified members of the SAAJ participated in the session. A questionnaire was subsequently sent to session participants and 84 responded, making for a 58% response ratio. This comment letter takes full consideration of the views expressed in the questionnaire replies as well as discussion among CAC members. The survey results, quoted from time to time in the following comments, are attached as an Appendix to this letter.

Revenue Recognition Principle Based on Contract Asset/Liability

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?

The discussion paper is an ambitious attempt by the Boards to substantially simplify current standards where a number of revenue recognition models coexist. The discussion paper proposes a revenue recognition principle motivated by the Boards' desire to integrate existing models theoretically. The CAC, however, cannot conclude that the practical advantages of adopting the proposed principle would clearly outweigh the problems caused by such adoption. In our opinion poll mentioned above, we asked "*Do you agree to the basic principle in the discussion paper?"* (See Appendix for exact wording.) The possible responses, "Agree", "Disagree", or "Cannot judge at this moment", each received about 1/3 support:

A1:*

Agree.	29	34.5%
Disagree.	24	28.6%
Cannot judge at this moment.	31	36.9%

To facilitate reference, this is the answer number in the Appendix. Same hereafter.

One reason for the varying opinions is that there are so many practical problems that cannot be answered from a reading of the discussion paper because the proposed principle is totally different from the realization-earnings model currently used.

The first problem many members pointed out is that the examples in the discussion paper are rather simple and they are not sure whether all complicated contracts could be clearly classified into separate performance obligations and wonder how revenue would be recognized under the asset liability model.

The second problem is how the value of performance obligations such as a warranty could be estimated in advance. Past experience could be used for an estimate, but it would be difficult to determine possible punitive damages as a reasonable estimate for a liability in advance.

The third problem is that the proposal would make the recording of transactions complex. For example, when a warranty and a product delivery obligation are recognized in different periods as separate obligations, then, for example, value-added taxes would have to be calculated each time. It is not clear that this increased burden would provide commensurate value for company analysis.

Indeed, as below, only 17% answered "Yes" to our survey question, *"Compared to current revenue recognition based on the earnings process approach, do you think revenue recognition based on the asset liability model proposed in the discussion paper would provide more useful information for company analysis?"*

A7:

Yes, I think so.	14	16.7%
No, I don't think so.	21	25.0%
Cannot judge at this moment.	49	58.3%

Unless these problems are resolved, the CAC is not convinced that the revenue recognition principle proposed in the discussion paper would provide transparent and objective revenue recognition that would eliminate the arbitrary interpretation which was one of the sources of various accounting malpractices in the past. The CAC respectfully asks the Boards to provide as many examples of complicated transactions as possible and to show how they are treated under the proposed model.

Measurement of Performance Obligations

Question 10 (a): Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

The CAC thinks the original transaction cost approach is appropriate for measuring performance obligations and appreciates the Boards' decision in adopting such approach. In our survey, about 50% of the respondents supported the original transaction price approach.

A2:

Support the original transaction price approach.	42	50.0%
Support the current exit price approach.	20	23.8%
Cannot judge at this moment.	20	26.2%

The discussion paper points out (a) pattern of revenue recognition, (b) complexity, and (c) risk of error, as the reasons that the Boards did not adopt the current exit price approach. The CAC shares the Boards' concern and thinks application of the approach would be problematic. The original transaction price approach, on the other hand, is more adaptable to business practices and it is easier to obtain objective prices using it. Thus, this approach would fit the Boards' objective in having clear and consistent standards.

However, it should be quickly added that not a few members pointed out that since (a) the current exit price approach, which is theoretically more suited to the asset liability approach, cannot be adopted because of difficulty of measurement etc., and (b) the original transaction price approach is proposed instead, there is little need to introduce the asset liability approach into revenue recognition in IFRS.

Remeasurement of Performance Obligations

Question 10 (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?

From the standpoint of timely disclosure, the CAC agrees to remeasurement when a contract becomes onerous. In order to maintain and enhance the reliability of financial statements, timely remeasurement and disclosure are indispensable. In our survey, some 63% agreed to the proposed remeasurement.

A6:

Agree.	53	63.1%
Disagree.	8	9.5%
Cannot judge at this moment.	23	27.4%

A performance obligation measured at the original transaction price can become inappropriate due to significant onerous changes in the situation. Hence, the need for remeasurement. Frequent remeasurements are surely costly and might confuse the depiction in financial statements, especially when the criteria for remeasurement are not clear. On the other hand, if cost considerations prevent remeasurement, the reliability of financial statements is destined to diminish. The CAC is thus opposed to using cost as an excuse for not remeasuring.

Some members opined that the recognition of provisions and impairments in current accounting standards provides equivalent information to that which can be provided by the proposed remeasurement under the asset liability approach. Thus, they question the necessity of the latter.

Satisfaction of Performance Obligations

Question 9: The boards propose that an entity should recognize 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.

Based upon the notion of transfer of control, the discussion paper distinguishes between a contract to provide a construction service (revenue is recognized as the service is provided) and a contract to deliver a completed property (revenue is recognized upon delivery). The CAC opposes this distinction as it would significantly limit application of the percentage of completion method and regards this as one of the most serious problems in the paper. In our survey we asked "*Do you think the distinction in the discussion paper will provide useful information for company analysis?*"—more than half of the respondents echoed the view of the CAC.

A4:

Yes, I think so.	24	28.6%
No, I don't think so.	44	52.4%
Cannot judge at this moment.	16	19.0%

Further, to those who chose "No, I don't think so" and "Cannot judge at this moment" above, we asked "*How can we obtain useful information for company analysis?*" to which about two-thirds requested use of the percent of completion method in industries such as construction and software development.

A5:

Relax the stipulations in the discussion paper to allow wider use of the percent of completion method.	10	16.7%
Regardless of the transfer of control, the percent of completion method should be allowed for long-term contracts, such as construction and software development, which satisfy certain criteria.	39	65.0%
Cannot judge at this moment.	11	18.3%

The CAC asks for expanded use of the percentage of completion method as it is better suited for company analysis and as it has contributed to better corporate governance as described below.

Company Analysis

The CAC thinks the advantage of the percentage of completion method, when applied to a long-term contract, is that it enables periodic allocation of economic benefits which will flow into the company with high probability. In other words, flow income thus allocated will better contribute to estimating future cash flow. If revenue from a long-term contract is recognized only upon delivery, the information usefulness of financial statements during the construction period would be substantially impaired.

Improved Corporate Governance ––A History

In the past, the completion basis was the principle in Japanese standards, but application of the percentage of completion method has gradually expanded in view of convergence to global standards, and today the percentage basis is the principle. When the completion method was used, process control during construction was so loose that huge losses that even management hadn't noticed had, in many cases, to be recognized upon delivery. As the percentage of completion method has become more widely used, companies manage the construction process more rigorously and make huge efforts to accurately estimate and monitor the profitability of a contract. If use of the percentage of completion method is prohibited, it would be regarded as the denial of history by turning back the clock, and thus carry the risk of a sudden loss of credibility in IFRS.

Propositions to Improve the Discussion Paper

The CAC thinks the percentage of completion method should be the principle for long-term contracts in the construction, plant engineering, software development, advertising, and other industries. If this is hard to accept for the Boards due to wanting to pursue consistency of standards and other considerations, then the Boards should list and describe many more cases where the percentage of completion method could be used. It is said that the percentage of completion method will be used for construction on land owned by a customer, and in jurisdictions where title is transferred to the customer as construction progresses. However, accounting standards that demand different recognition in different jurisdictions would hardly be considered a single set of high quality global standards. If the Boards do not adhere overly strictly to the control concept, they would find many cases where the percentage of completion method was more reasonable, including a construction contract where the customer makes multiple payments upon inspection and a long-term software development contract which is tailor-made for a customer.

Accounting Standards Should Depict Economic Reality

The discussion paper proposes a revenue recognition model based on the asset liability approach and therefore emphasizes the concept of control, which results in different accounting recognition under different legal systems as mentioned above. The CAC thinks corporate accounting should depict economic reality, not legal relationships. Transactions carrying the same economic reality should be treated in the same way, regardless of the legal relationship. This point is particularly important for IFRS which are aimed at being adopted in countries with widely different jurisdictions. The CAC is not in a position to conceptually deny the asset liability approach, but is afraid that mechanical application of it, particularly of the control concept*, might end up with irrational accounting standard propositions. The CAC respectfully asks the Boards to prudently consider this matter bearing in mind the future development of IFRS.

*According to one member, a proposition in the "*Derecognition*" exposure draft which recognizes repos and stock lendings as sales, is another example of the mechanical application of the control concept.

Concluding Remarks

The CAC highly evaluates the praiseworthy objective of the Boards in wanting to establish better IFRS by aiming to have a single revenue recognition model which eliminates arbitrariness. However, each recognition model that exists today has been historically developed as a rational standard to depict the economic reality of a company which belongs to a particular industry. The CAC believes that the Boards will not make the mistake of denying rational accounting conventions that are widely used in practice by overly emphasizing theoretical consistency. Over-simplification involves the risk of making things worse than they are today.

Many issues should be discussed further for the establishment of better IFRS. The CAC is committed to digesting the discussions of the Boards and to expressing its opinions at every opportunity in such a way as to cooperate with the Boards to realize the objectives.

If you have any questions or need further elaboration, please do not hesitate to contact Sei-Ichi Kaneko, Executive Vice President, SAAJ (s-kaneko@saa.or.jp).

Sincerely yours,

Keiko Kitamura

Keiko Kitamura
Chair
Corporate Accounting Committee

APPENDIX

Results of SAAJ Survey on
'Revenue Recognition on Contracts with Customers'

Background and methodology

The Securities Analysts Association of Japan (SAAJ) sponsored a study session on IASB/FASB's discussion paper *Preliminary Views on Revenue Recognition in Contracts with Customers*, inviting two staff from the Accounting Standards Board of Japan (ASBJ) as lecturers. Some 146 certified members of the SAAJ participated in the session held on 20 April. A questionnaire was subsequently sent to session participants and 84 responded, making for a 58% response ratio. The respondents could also add comments. The survey, although small in size, focused on a cohort with the same background (certified members of the SAAJ) and same knowledge level (participation in the study session). This focus and very high response rate gives credibility to the reliability of the survey.

Survey questions and answers

Q1: The discussion paper *Preliminary Views on Revenue Recognition in Contracts with Customer*s, introduces the asset liability approach and proposes a model that, based on a contract with a customer, measures rights and obligations to record the net amount as contractual assets or liabilities. Changes in contractual assets/liabilities are regarded as performance (revenue) for the period. For the measurement of performance obligations, the discussion paper proposes using "asset value to satisfy the obligations" which is the present value of expected costs including margins.   Do you agree or disagree with this view?

A1:

Agree.	29	34.5%
Disagree.	24	28.6%
Cannot judge at this moment.	31	36.9%

Q2: In measuring performance obligations, the discussion paper proposes the original transaction price approach which measures a performance obligation by the consideration the customer promises in exchange for the promised goods and services. The obligation will not be updated unless it is deemed onerous. The revenue recognized under the proposed approach is similar to that recognized under the earnings process approach. The discussion paper also introduces the current exit price approach which measures performance obligations by the price that the company would be required to pay to transfer those obligations to an independent third party on the financial statement date. The discussion paper suggests considering the use of such an approach for remeasurement of certain contracts. What do you think of the two approaches?

A2:

Support the original transaction price approach.	42	50.0%
Support the current exit price approach.	20	23.8%
Cannot judge at this moment.	20	26.2%

Q3: The discussion paper defines performance obligation as "a promise in a contract with a customer to transfer an asset (such as a good or a service) to that customer" and asks for revenue to be recognized when the obligation is satisfied. For example, if a company sold goods with a right of return and a warranty, each will be recognized as an independent obligation. A portion of the customer consideration will be allocated to these obligations and revenue recognized when the obligation is satisfied. Do you think, as a consequence of this proposal, companies can systematically recognize various revenues associated with contracts that provide multiple goods and services?

A3:

Yes, I think so.	24	28.6%
No, I don't think so.	30	35.7%
Cannot judge at this moment.	30	35.7%

Q4: The discussion paper says "an entity satisfies a performance obligation and, hence, recognizes revenue when it transfers a promised asset (such as a good or a service) to the customer." Based upon this, the percent of completion method, which is widely used in the construction industry, is said to be significantly affected. According to the discussion paper, if the contract is to provide construction services, then revenue will be recognized as the service is provided, and if the contract is to provide a fully built property, revenue will be recognized upon completion. If the customer controls the property during construction, the contract will be deemed to be providing services. An example in the discussion paper stipulates that if the customer owns the land, then he will be deemed to have control. Do you think the distinction in the discussion paper will provide useful information for company analysis?

A4:

Yes, I think so. (Go to Q6)	24	28.6%
No, I don't think so. (Go to Q5)	44	52.4%
Cannot judge at this moment. (Go to Q5)	16	19.0%

Q5: How can we obtain useful information for company analysis?
(Answer only if you said 'No' or 'Cannot judge at this moment.' to Q4.

A5:

Relax the stipulations in the discussion paper to allow wider use of the percent of completion method.	10	16.7%
Regardless of the transfer of control, the percent of completion method should be allowed for long-term contracts, such as construction and software development, which satisfy certain criteria.	39	65.0%
Cannot judge at this moment.	11	18.3%

Q6: The discussion paper proposes measuring performance obligation by the original transaction price except in onerous situations where the expected cost exceeds book value of the obligation. In this case, performance obligation should be remeasured and a loss recognized. Do you agree with this exceptional remeasurement and loss recognition?

A6:

Agree.	53	63.1%
Disagree.	8	9.5%
Cannot judge at this moment.	23	27.4%

Q7: Compared to current revenue recognition based on the earning process approach, do you think revenue recognition based on the asset liability model proposed in the discussion paper would provide more useful information for company analysis?

A7:

Yes, I think so.	14	16.7%
No, I don’t think so.	21	25.0%
Cannot judge at this moment.	49	58.3%