



22 October, 2010

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

Dear Board Members:

Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF), the accounting standard setting body in Mexico, welcomes the opportunity to submit its comments on the Exposure Draft on *Revenues from Contracts with Customers* (the ED), issued for exposure in June 2010. Set forth below you will find our comments on the topics included in the ED, as well as our responses to the questions included therein.

We have divided our letter in two sections. In the first section you will find our general comments on the ED. The second section includes our responses to the specific questions raised in the ED.

General comments on the ED

We wholeheartedly applaud the coordinated efforts of the IASB and the FASB to issue this joint exposure draft on revenue recognition. We are certain that this effort will significantly improve financial reporting by establishing consistent revenue recognition criteria between US GAAP and IFRS, thereby alleviating related concerns expressed by regulators, including the US Securities and Exchange Commission, regarding differences in the timing of revenue recognition under US GAAP and IFRS.

We agree that a contract-based revenue recognition principle is the most appropriate principle for a general revenue recognition standard for contracts with customers. Accordingly, we also agree that revenue should be recognized only when an entity transfers a promised good or service to a customer, thereby satisfying a performance obligation in the contract.

However, we are uncertain that some of the provisions of the ED will actually improve financial reporting, specifically with respect to:

- Allocation of the total transaction price to all separate performance obligations in a contract in proportion to the standalone selling price of the good or service underlying each of the performance obligations.
- Recognition of variable consideration based on a probability-weighted amount of consideration the entity expects to receive.

- Reductions of revenue for product warranties related to reparable defects in the products sold.
- Basing the pattern of revenue recognition on whether the license is exclusive.
- Onerous disclosure requirements.

Our responses to the specific questions raised in the ED

Recognition of revenue (paragraphs 8–33)

Question 1: Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether to:

- (a) combine two or more contracts and account for them as a single contract;
- (b) segment a single contract and account for it as two or more contracts; and
- (c) account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

Yes, we agree that price interdependence is an appropriate principle for the combination and segmentation of contracts.

Question 2: The Boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

Yes, we agree with the principle that in order to account for a promised good or service as a separate performance obligation within a contract with a customer, such good or service must be distinct.

Question 3: Do you think that the proposed guidance in paragraphs 25–31 and related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

We agree that an approach that focuses on control rather than a risk and rewards approach should result in more consistent decisions about when goods and services are transferred and a performance obligation has been satisfied. We also agree that the proposed indicators of control should be applied from the perspective of the customer.

However, with respect to the proposed guidance, we believe the concern expressed by respondents to the Discussion Paper regarding the application of the control guidance to contracts in the construction industry has not been alleviated. Paragraph B65 states “If the customer does not control the asset as it is produced, manufactured, or constructed, the contract is to transfer a completed asset. In that situation, an entity shall recognize revenue only when the customer obtains control of the completed asset.” This is confirmed in paragraph BC65, which indicates that “In the case of a construction contract, the customer receives the promised goods or services during construction only if the customer controls the work in process (“WIP”).”

These paragraphs establish that the goods and services in a construction contract must be transferred continuously to qualify for what is known as the percentage-of-completion accounting method. Continuous transfer occurs only when the customer has the ability to direct the use of, and receive the benefits from, the WIP. Although paragraph BC65 states "The Boards did not intend that revenue should be recognized only upon contract completion," we question whether the guidance will not in fact result in revenue from many construction contracts, including those currently accounted for under the percentage-of-completion method pursuant to existing guidance, being recognized until completion. Accordingly, we recommend clarification of the conditions required to support control of WIP during construction activity where there is satisfaction of performance obligations without clear transfer of control.

Measurement of revenue (paragraphs 34–53)

Question 4: The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?

Yes, we agree that an entity should recognize revenue on the basis of an estimated transaction price. However, we are not convinced that the probability-weighted amount of consideration the entity expects to receive, as described in paragraph 37, is an appropriate measurement of revenue. In the case of performance bonuses or penalties, for example, generally the entity receives/pays all or none of the bonus/penalty. The probability-weighted amount will never be the amount ultimately received/paid by the entity.

We believe a more reasonable and supportable approach for contingent revenue such as a performance bonus would be to recognize the related revenue only when earned, since to do otherwise is equivalent to the recognition of a contingent gain. On the other hand, we believe any performance penalties or reductions of revenue should be recognized based on a more likely than not approach, wherein all or none of the liability is recognized.

We also agree that the criteria in paragraph 38 that an entity should meet to be able to reasonably estimate the transaction price are appropriate.

Question 5: Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect *how much* revenue an entity recognizes when it satisfies a performance obligation rather than *whether* the entity recognizes revenue? If not, why?

Yes, we agree that the customer's credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue. This is consistent with other standards wherein probability, for example, is a factor that enters into the measurement of a guarantee liability, but it is not a factor in the decision to recognize such liability.

Question 6: Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

Yes, we agree that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component.

Question 7: Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

No, we do not agree that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each of those performance obligations.

Consider the following example, assuming the seller can demonstrate that the license and maintenance services are separate performance obligations as defined in the ED:

	Standalone prices			Allocation per 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%

As this allocation method ignores the economic substance of how the individual elements within the bundled arrangement have been priced, it results in an increase in the margin on the product license and a loss on the maintenance services, which would require recognition of an onerous contract provision at contract inception.

We believe that a better approach would be to consider the bundled arrangement as a separate product and that the bundled profit margin be maintained 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.

*Attached for your consideration you will find several examples in **Exhibit 1** to show the impact on the allocation of the transaction price when the bundled margin is equal to or less than the standalone margin for the maintenance services.*

Additionally, we recommend that guidance be provided to address a situation where the sum of the standalone selling prices of the identified goods or services underlying each of the performance obligations appears to be less than the bundled transaction price. In such a case, it would appear that the entity has not adequately identified all of its separate performance obligations as required by paragraph 20 of the ED, since it is highly unlikely that the transaction price for a contract with multiple deliverables would be greater than the sum

of the standalone selling prices of the identified goods or services underlying each of the performance obligations.

Contract costs (paragraphs 57–63)

Question 8: Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38, *Intangible Assets*, or ASC Topic 985 on software), an entity should recognize an asset only if those costs meet specified criteria.

Do you think that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient? If not, why?

Yes, we believe that proposed guidance is operational and sufficient, since it establishes that costs incurred in fulfilling a contract that (1) are directly related to a contract, (2) will be used to satisfy future performance obligations and (3) are recoverable may be recognized as an asset.

Question 9: Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

Yes, we agree with the costs specified, since the guidance establishes that costs incurred in fulfilling a contract that are both direct and incremental may be capitalized.

Disclosure (paragraphs 69–83)

Question 10: The objective of the Boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

We agree that the proposed disclosure requirements will definitely help users of financial statements understand the revenue cycle of the entity. However, we question whether entities are prepared and, more importantly, willing to provide the volume and detailed nature of the information requested by the ED. Far less detailed disclosures have been resisted in the past since the entities have frequently maintained that such information is extremely useful to competitors.

Question 11: The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

We partially agree with the proposed disclosure requirement. We believe that disclosure of the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year is sufficient. We do not see any significant benefit for additionally disclosing those performance

obligations expected to be satisfied between one and two years, two and three years, and later than three years.

Question 12: Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

We agree that the proposed disaggregation of revenues based on the categories described in paragraph 74 would prove to be very useful and informative to users of financial statements.

Effective date and transition (paragraphs 84 and 85)

Question 13: Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

While retrospective application clearly results in comparable financial information between reporting periods, many large entities with hundreds or even thousands of outstanding contracts with customers will require a significant amount of time for system changes and accumulation of information for revised revenue recognition policies and significant additional disclosure requirements. Accordingly, the effective date should be at least two years after issuance of the final standard. On the other hand, if the goal of consistent revenue recognition under US GAAP and IFRS is to be achieved as soon as possible, prospective application should be considered, with the appropriate disclosures to address any lack of comparability.

The only alternative transition method that comes to mind that would preserve trend information about revenue would be to estimate and disclose what prior year revenues would have been, based on the impact on revenues in the year of adoption on a prospective basis.

Application guidance (paragraphs B1–B96)

Question 14: The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance. Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

In general, the examples included throughout the implementation guidance do a very good job of explaining the proposals and making them operational. However, we believe the required journal entries, as presented in Examples 14 and 29, would prove useful in several other examples, such as Examples 3 and 4, to ensure proper application of the guidance. For example, we recommend that Example 3 include the journal entries upon (1) transfer of control of the products and (2) exercise of the right of return. Example 4 should include the journal entries upon (1) transfer of control of the products, (2) change in the conditions resulting in a revised estimate of products to be returned, and (3) replacement of the products.

Question 15: The Boards propose that an entity should distinguish between the following types of product warranties:

- (a) a warranty that provides a customer with coverage for latent defects in the product.
This does not give rise to a performance obligation but requires an evaluation of

whether the entity has satisfied its performance obligation to transfer the product specified in the contract.

- (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

Yes, we agree with the proposed distinction between the types of product warranties.

If the product is to be returned for refund or replaced with a substitute product, then it would appear appropriate to record a sales allowance that would be deducted from gross sales to arrive at net sales. However, we do not believe that revenues should be reduced for product warranties that will result in the repair of either latent defects or faults that arise after the product is transferred to the customer. We believe that the cost of such repairs should be recognized as a cost or expense, as opposed to a reduction of revenue.

Additionally, in the example where the product warranty is not a performance obligation (see Example 4), the asset recognized for the defective products does not represent “inventory that the entity has not yet transferred to the customer”. In actuality, the defective products were already transferred to the customer, and the replacement products, which remain in inventory, represent the inventory that the entity has not yet transferred to the customer, not the asset suggested in Example 4. Effectively, the asset recognized for the defective products represents inventory in the possession and in the control of the customer that is expected to be returned to the entity. Nevertheless, since the defective products are not the promised goods, the performance obligation has not been met, which is why the related revenue should not be recognized. The related asset should be recognized as returnable inventory.

We recommend also providing an example of the allocation of the transaction price between the promised product and the promised warranty service in the case where the objective of the product warranty is to provide a customer with coverage for faults that arise after the product is transferred to the customer.

Question 16: The Boards propose the following if a license is not considered to be a sale of intellectual property:

- (a) if an entity grants a customer an exclusive license to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the license; and
- (b) if an entity grants a customer a nonexclusive license to use its intellectual property, it has a performance obligation to transfer the license and it satisfies that obligation when the customer is able to use and benefit from the license.

Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the patterns of revenue recognition proposed by the Boards? Why or why not?

No, we are not convinced that the revenue recognition should depend on whether the license is exclusive. We note the following application guidance in paragraphs B33 – B35:

- (i) *If an exclusive license is granted for substantially all of the property’s economic life, the customer is considered to have obtained control of substantially all the rights associated with the entity’s intellectual property, and accordingly the contract is*

considered to be a sale rather than a license, resulting in a performance obligation that is satisfied when the customer is able to use and benefits from the rights.

- (ii) If an exclusive license is not granted for substantially all of the property's economic life, the customer is not considered to have obtained control of substantially all the rights associated with the entity's intellectual property, resulting in a performance obligation that is satisfied continuously over the term of the license.*
- (iii) If a nonexclusive license is granted, a single performance obligation arises that is satisfied when the customer is able to use and benefits from the rights.*

In (i) and (iii) above, the performance obligation is satisfied and the related revenue is typically recognized up front at the beginning of the license period. However, in (ii) the guidance suggests that the performance obligation is satisfied and the related revenue is recognized over the license period. We believe that in all three cases the performance obligation is satisfied when the customer is able to use and benefits from the rights and would not defer revenue recognition.

Consequential amendments

Question 17: The Boards propose that in accounting for the gain or loss on the sale of some nonfinancial assets (for example, intangible assets and property, plant, and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

Yes, we agree that the recognition and measurement principles of the proposed revenue model should apply to accounting for the gain or loss on the sale of some nonfinancial assets.

Nonpublic entities

Question 18: Should any of the proposed guidance be different for nonpublic entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?

Yes. Although we believe that the proposed guidance for the recognition of revenues from contracts with customers should not be different for nonpublic entities, we believe that the disclosure requirements should be reduced for nonpublic entities.

Should you require additional information on our comments listed above, please contact William A. Biese at (52) 55 5596 5633 ext. 113 or me at (52) 55 5596 5633 ext. 103 or by e-mail at wbiese@cinif.org.mx or fperezcervantes@cinif.org.mx, respectively.

Sincerely,

C.P.C. Felipe Perez Cervantes
President of the Mexican Financial Reporting Standards Board
Consejo Mexicano para la Investigacion y Desarrollo
de Normas de Informacion Financiera (CINIF)

Exhibit 1

Allocation per ED:

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

Proposed revised allocation:

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

Bundled margin equal to standalone maintenance margin:

	<i>Standalone prices</i>			<i>Proposed revised allocation</i>		
	<i>Product license</i>	<i>Maintenance services</i>	<i>Bundled arrangement</i>	<i>Product license</i>	<i>Maintenance services</i>	<i>Total</i>
<i>Selling price</i>	\$100,000	\$100,000	\$141,000	\$41,000	\$100,000	\$141,000
<i>Cost</i>	35,000	85,000	120,000	35,000	85,000	120,000
<i>Margin</i>	\$65,000	\$15,000	\$21,000	\$6,000	\$15,000	\$21,000
<i>Margin %</i>	65%	15%	15%	15%	15%	15%

Bundled margin lower than standalone maintenance margin:

	<i>Standalone prices</i>			<i>Proposed revised allocation</i>		
	<i>Product license</i>	<i>Maintenance services</i>	<i>Bundled arrangement</i>	<i>Product license</i>	<i>Maintenance services</i>	<i>Total</i>
<i>Selling price</i>	\$100,000	\$100,000	\$133,000	\$39,000	\$94,000	\$133,000
<i>Cost</i>	35,000	85,000	120,000	35,000	85,000	120,000
<i>Margin</i>	\$65,000	\$15,000	\$13,000	\$4,000	\$9,000	\$13,000
<i>Margin %</i>	65%	15%	10%	10%	10%	10%