SwissHoldings

Verband der Industrie- und Dienstleistungskonzerne in der Schweiz
Fédération des groupes industriels et de services en Suisse
Federation of Industrial and Service Groups in Switzerland

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EFRAG
13-14 Avenue des Arts
B-1210 Brussels

Belgium

Comments on PAAinE Discussion Paper on Revenue Recognition

Dear Sir / Madam

SwissHoldings (formerly Industrie-Holding, the Swiss Federation of Direct Investors) represents 44 Swiss groups, including most of the country's major industrial and commercial firms. We very much welcome the opportunity to comment on the above DP, and our response below has been prepared in conjunction with our member companies.

The DP provides a very interesting conceptual look at the issue of revenue recognition and, through the various examples, makes a valiant attempt at relating the concepts to practice. Yet in the final analysis, as the IASB's DP on the Objectives of Financial Reporting correctly observes in OB6, "Financial reporting is not an end in itself. It is a means of communicating to the users of financial reports information that is useful in making choices among alternative uses of scarce resources." In this context we have considerable difficulty relating to the conclusion of the PAAinE DP – or at least of the GASB - that the comprehensive application of a **continuous activity approach** would lead to the provision of more meaningful and useful information to the users of financial statements.

We are puzzled that users consulted during preparation of the DP would have supported this view. Those users with whom our members have direct contact do not generally seem to share it: they support the **continuous activity approach** reflected in IAS 11 as a basis for their analysis of long-term construction businesses but appear to prefer a **critical event basis** which they can better understand and rely more upon as a measure of the activity resulting in sales of goods. Put another way, while there are occasional problems with POCM for recognising revenue from services under IAS 18, especially in multiple-element arrangements, the present separation between recognition on the basis of the critical event approach for sales of goods and on the basis of percentage-of-completion method for construction contracts works pretty well – indeed perfectly adequately for the overwhelming majority of transactions -, and we find it difficult to accept under these circumstances that anything more than the development of practical, pragmatic solutions for the few, very specific grey areas like sales of real estate sales (IFRIC D21) and multiple-element transactions is necessary or would lead to more meaningful and useful information for financial statement users.

Further, we have substantial doubts about the whole search for some **single, theoretical principle for revenue recognition.** Consistency can surely not mean that differing transactions cannot be reflected differently in financial reporting, especially when the resulting information on an entity's operations would tend to score lower on tests of understandability, relevance and reliability and give a false impression on comparability – even before the cost aspects are considered. The strong objections

Postfach 402, 3000 Bern 7
Tel. +41 (0)31 356 68 68
sh@swissholdings.ch

Nägeligasse 13, 3011 Bern
Fax +41 (0)31 352 32 55
www.swissholdings.ch

which the Corporate Reporting Users Forum (CRUF) raised in their letter of October 27 to the IASB and FASB on Performance Reporting and the threatened suppression of net income could be repeated almost verbatim in respect of this DP. Why dismantle something which works, which is the basis for the majority of transactions and hence transactional accounting systems and which is of considerable practical use to both users and preparers merely because of some perceived conceptual imperfections that disturb only those indirectly involved? Enhancements of the current standards to give guidance on issues that are experienced in practice would suffice. One might also bear in mind that the IASB itself does not seem particularly uncomfortable with having “inconsistent” approaches to (e.g.) the recognition of internally generated and external goodwill and impairment reversals on goodwill and equity securities as opposed to other impairment reversals.

As with other current developments in standards, a large part of the problem is caused by the desire to apply an **asset/liability approach** which is ill suited to giving a meaningful picture of real, underlying business performance as most users and preparers understand and want to see it. And with such an approach the aspect of measurement and its impact on the meaningfulness of the information become very important and cannot be ignored, as the DP does.

On the **deterioration** in the level of meaningful and useful financial information which the comprehensive application of the continuous activity approach would give rise to in many if not most areas, we take the example of a pharmaceuticals firm which manufactures a flu drug both to order (government orders for pandemic emergency supplies) and for “normal” sale ex stock to distributors and pharmacies. As we understand it, the approach would require the firm to recognise revenue (and therefore profit) over the months of the production cycle in the first case but only on shipment in the second. The user would therefore be faced with a less understandable, mixed pattern of revenues which he would require substantial further information to properly understand and to compare between firms and on which he could place less reliance because of the subjective elements included in the measurements. Meanwhile, the preparer would have had to incur substantial additional costs to produce revenue information which does not reflect the way he runs the business, which management will not be able to relate to and which is not what the “consumer” of the financial statements finds more useful.

The DP appears to us to substantially **underestimate the extra costs** for firms not currently using a continuous activity approach to revenue recognition to apply it. Since non-realised revenue accruals would very likely be excluded from internal financial reporting as neither meaningful nor helpful as well as costly to produce, they would very often become quarter-end bolt-ons purely for external reporting, prepared with the focus on minimising resources expended: this would be a further **wedge driven between internal and external financial reporting.** It should be recalled that, despite the asset/liability approach, revenue still stems directly from innumerable individual transactions: it would be contrary to the basic cost/benefit principle to impose the enormous systems changes implied just for the sake of having one conceptual revenue recognition principle without significant practical advantages in better information for users being identified.

In summary, while the DP performs a very worthwhile service in highlighting some of the conceptual issues involved in revenue recognition, we believe that its attempt to discern a single, consistent principle takes insufficient cognizance of the differing situations to be reflected: Power plant construction contracts are different animals from food products and need to be so represented as to properly reflect the differences. A more pragmatic approach of looking for:

- practical criteria to distinguish between situations where such a continuous activity approach yields more meaningful and useful information from those where it does not, and
- workable solutions to the minor grey areas in revenue recognition (multi-element transactions etc.)

would promote the beneficial evolution of revenue recognition standards rather more than a **revolutionary approach** which may be conceptually satisfying but which brings only downsides for preparers and users, the primary parties involved in financial reporting.

Yours sincerely

SwissHoldings
Federation of Industrial and Service Groups in Switzerland

Dr. Peter Baumgartner
Chairman Executive Committee

Dr. Jan Atteslander
Member Executive Committee

cc SH-Board