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THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

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Project: Revenue Recognition
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Preliminary Views on Revenue Recognition in Contracts with Customers

The proposal that contract reporting should start from recognition of the respective assets and liabilities arising under the contract is sensible. Measurement of the value of these assets and liabilities is then crucial to understanding the effect on financial statements and in particular on reported income. But here the discussion paper deconstructs. In Chapter 5 the possibility is raised that if the value of the asset at inception exceeds that of the liability a 'Day 1 profit' would be shown. (In the converse situation, i.e. where the value of the liability at inception exceeds that of the asset, it has long been standard accounting practice, at least in the US and the UK, that the contract is deemed 'onerous' and a 'Day 1 loss' is shown.) But the Boards are stated (at para. 5.20) to be 'uncomfortable' with the potential implication of valuing contract assets and liabilities at inception in that it could lead to recognition of 'Day 1' revenue and income 'before the entity transfers to the customer any of the goods and services that are promised in the contract'.

'Uncomfortable' is not a concept/criterion that has appeared before in the Boards' conceptual frameworks. This 'discomfort' here however seems very wise: and also nicely illustrates the inevitable continuing power of 'conventions'—in this case 'matching'—at the heart of conceptual debates, which shows that the Boards' initial May 2005 staff paper (by Bullen and Crook) on the CF convergence project was misguided in claiming that 'to be principles-based, standards cannot be a collection of conventions but rather must be rooted in fundamental concepts'. What it should have said was that 'To be principles-based, standards have to be a collection of (socially) useful conventions, rooted in fundamental concepts.' This is discussed more fully in Bromwich, M., Macve, R., and Sunder, S. *FASB/IASB Revisiting the Concepts: a comment on Hicks and the concept of 'income' in the conceptual framework* a working version of which is available on my website: http://www.lse.ac.uk/collections/accounting/facultyAndStaff/profiles/macve.htm

In my view the problem within Chapter 5 of the *Preliminary Views* could largely be resolved if the Boards adopted 'deprival value' as the basis for measurement of assets (and its mirror 'relief value' for liabilities.) The arguments are set out more fully in Macve, R. and Serafeim, G., *'Deprival Value' vs 'Fair Value' Measurement for Contract Liabilities in Resolving the 'Revenue Recognition' Conundrum: Towards a General Solution*, a working version of which is also available on my website: http://www.lse.ac.uk/collections/accounting/facultyAndStaff/profiles/macve.htm . (I will be submitting a further comment in due course to IASB on the inadequacy of the discussion of 'deprival value' in BC65-66 of its May 2009 Exposure Draft on *Fair Value Measurement*.)

I conclude that these *Preliminary Views* should go back to the drawing board.

Sincerely, Richard Macve