

Letter of Comment No: 1
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Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Proposed FASB Staff Position (FSP) FAS 143-a

Dear Mr. Smith:

IBM appreciates the opportunity to comment on FSP FAS 143-a, *Accounting for Electronic Equipment Waste Obligations*. We support the issuance of the FSP and generally agree with the proposed accounting model. However, we believe that the FSP should provide additional recognition and measurement guidance in order to prevent inconsistent interpretation by preparers and improve the comparability of financial statements.

Organization of the Comment Letter

This letter addresses the following issues included in the FASB staff's request for comments:

Issue 1: Do you agree that guidance is necessary to address the accounting for electronic equipment waste obligations associated with historical waste held by commercial users and private households?

Issue 2: Do you believe that the liability for obligations associated with historical waste held by commercial users and private households within the EU-member countries will be of such significance to entities preparing financial statements in accordance with U.S. GAAP that authoritative guidance should be provided by the Board?

Additionally, the letter raises the following issues related to recognition and measurement guidance for sales to commercial users:

Issue 3: The FASB should consider clarifying measurement guidance provided in paragraph 8 of the FSP.

Issue 4: The FASB should consider providing guidance on recognition of an asset retirement cost by the producer in revenue transactions.

Issue 5: The FASB should consider providing guidance on how the producer should account for subsequent resale of products for which the producer's previously assumed ARO liability is transferred to the new commercial user.

Issue 1: Do you agree that guidance is necessary to address the accounting for electronic equipment waste obligations associated with historical waste held by commercial users and private households?

We agree that guidance on the accounting treatment of historical waste is necessary and believe that it will improve comparability of financial statements. We also support the issuance of this FSP because it is responsive to the objective of international convergence. As such, we believe that this FSP and IFRIC Interpretation D10 should become effective in the same reporting period. Additionally, we recommend that the final FSP include a comparison of the provisions of the FSP and Interpretation D10 highlighting similarities and differences.

Issue 2: Do you believe that the liability for obligations associated with historical waste held by commercial users and private households within the EU-member countries will be of such significance to entities preparing financial statements in accordance with U.S. GAAP that authoritative guidance should be provided by the Board?

We agree that for certain US reporting entities doing business in EU-member countries, the liability might be significant enough to warrant issuance of authoritative guidance by the FASB.

Issue 3: The FASB should consider clarifying measurement guidance provided in paragraph 8 of the FSP.

According to paragraph 8, the commercial user is required to measure the replacement (new) asset by reference to the amount at which the asset could be exchanged in a current transaction between knowledgeable, unrelated willing parties without the assumption of the retirement obligation. That amount is used to (a) establish the cost basis of the new asset, (b) compute (as a residual) the portion of the total amount paid that relates to the transfer of the ARO to the producer of the replacement equipment, and (c) calculate the gain or loss resulting from that transfer.

We believe that the FSP should further clarify how the replacement asset should be measured. That is because guidance in paragraph 8 may have two (mutually exclusive) interpretations. It may be understood to require estimates that are either:

- (a) Based on prices in actual market transactions for largely interchangeable products in sales to similarly situated entities (by analogy to EITF Issue 00-21, *Revenue Arrangements with Multiple Deliverables*) or
- (b) Developed by means of appropriate valuation techniques similar to those used to measure the fair value of assets acquired in business combinations (or asset purchases).

Standalone Prices in Actual Market Transactions

If the estimate in paragraph 8 should be supported by standalone prices in actual market transactions, that evidence may not be readily available to the commercial user in other-than-active markets. That is because producers generally do not disclose their pricing and discounting practices or sufficiently detailed historical product sales information. Accordingly, the Board may wish to clarify accounting for the replacement transaction when the standalone price of the replacement asset cannot be reliably estimated. For example, the commercial user may be able to measure that asset as the excess of the price paid over the fair value of the ARO transferred. (In that case, the gain (loss) recognized upon the transfer of the ARO would equal the difference between the fair value of the ARO and its carrying amount on the date of the transfer.)

Alternatively, the Board may consider measuring the replacement asset as a residual (the excess of the price paid over the fair value of the ARO transferred) regardless of whether the standalone price of the asset acquired can be reliably estimated. That is because if the producer assumed the ARO liability in a separate transaction (unrelated to the sale of the new product), it would demand payment equal to the fair value of the ARO transferred.¹

Other Valuation Techniques

If the estimate required by paragraph 8 does not have to be supported by standalone prices in actual market transactions (that is, if the reliability threshold is lower than that in revenue transactions under Issue 00-21), the commercial user may be able to develop its estimates using various valuation techniques and pricing data points, including pricing data from brokers, market research firms, or other relevant sources used to support purchasing decisions. The question for the Board is whether an estimate that is developed by means of relevant valuation techniques would be viewed as sufficiently reliable for purposes of gain (loss) recognition under paragraph 8 of the FSP?

Issue 4: The FASB should consider providing guidance on recognition of an asset retirement cost by the producer in revenue transactions

According to paragraph 8, the producer of the replacement equipment would recognize a liability for the fair value of the ARO upon the transfer of that obligation from the commercial user. Presumably, the producer also would consider adjusting its product price to compensate for the assumption of the ARO liability.² Since the producer does not have the related long-lived asset, how should the producer account for:

- Asset retirement costs associated with the ARO liability at initial recognition,

¹ We also observe that this approach may allow for the “mirror-image” accounting by the commercial user (the customer) and the producer (the seller).

² In certain instances, the producer may be able to pass that cost on to commercial users. However, in certain markets, the producer may have to absorb that cost due to competitive pressures or other considerations.

- Subsequent changes in the ARO carrying amount resulting from revisions to the timing or the amount of the original estimate of undiscounted cash flows, and
- Derecognition of the ARO liability upon settlement?

The Board could consider the following alternative models:

Alternative 1: The asset retirement cost should be expensed as incurred (upon assumption of the ARO liability) similar to warranty costs. Subsequent changes resulting from revisions to the timing or the amount of the original estimate of undiscounted cash flows should be charged (credited) to expense. When the ARO liability is settled, the producer should derecognize that liability and recognize a settlement gain (loss) for the excess of the amount paid over the carrying amount of the ARO liability.

Under Alternative 1, total revenue on the replacement equipment would equal the price paid by the customer. That revenue would be recognized before the ARO liability is settled by the producer.

Alternative 2: The assumption of the ARO liability is not a revenue-generating activity, and the portion of the contract price related to the ARO transfer should never be recorded as revenue. Total revenue should be measured as the excess of the price paid by the customer over the fair value of the ARO liability assumed by the producer (effectively, the asset retirement cost would be treated as a reduction of revenue). Subsequent changes resulting from revisions to the timing or the amount of the original estimate of undiscounted cash flows should be recognized as holding gains (losses). When the ARO liability is settled, the producer should derecognize that liability and recognize a settlement gain (loss) for the excess of the amount paid over the carrying amount of the ARO liability.

Under Alternative 2, total revenue on the replacement equipment would be lower than the price paid by the customer in the replacement transaction.

Alternative 3: The ARO liability is one of the producer's bona fide performance obligations in the revenue transaction. As such, revenue relating to that obligation should not be recognized until the ARO liability is settled (either extinguished or transferred to a third party). Subsequent changes resulting from revisions to the timing or the amount of the original estimate of undiscounted cash flows should be recognized as revenue (reduction of revenue). When the ARO liability is settled, the producer should derecognize that liability and recognize the corresponding amount as revenue. At the same time, the producer should recognize an asset retirement cost with the offsetting credit to cash or payables.

Under Alternative 3, total revenue on the replacement equipment would equal the price paid by the customer, as adjusted for changes in the carrying amount of the ARO between the date of assumption and settlement. In contrast to Alternative 1, the portion of the contract price relating to the ARO liability would not be recognized as revenue until that liability is settled.

We believe that if the Board does not provide guidance on Issue 4, most reporting entities will select Alternative 1 due to its relative simplicity. If the Board agrees to provide additional guidance, we suggest that the Board consider including an additional example that would describe the producer's accounting for the sale of the replacement equipment to the commercial user.

Issue 5 that is discussed below is closely related to Issue 4 in that it takes the transaction cycle a step further to assume that the ARO liability is subsequently transferred to another commercial user in a separate revenue transaction.

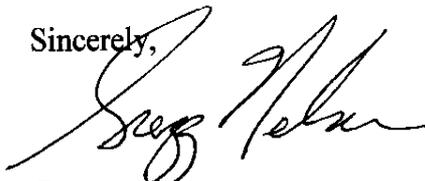
Issue 5: The FASB should consider providing guidance on how the producer should account for subsequent resale of products for which the producer's previously assumed ARO liability is transferred to the new commercial user.

In certain instances, the producer may subsequently refurbish and resell the product for which it assumed an ARO liability in the replacement transaction. In some countries, upon resale of the product, the ARO liability might transfer to the new commercial user that purchases that refurbished product.³ How should the producer account for the resale transaction? Should the producer derecognize the carrying amount of the ARO liability and recognize a gain (loss) equal to the difference between its carrying amount and its fair value on the date of transfer? What is the nature of the offsetting credit? Is it a (reduction of) expense, revenue, or gain?

We believe that if the Board chooses not to provide guidance on Issue 5, most reporting entities would treat that credit as a reduction of expense (consistent with Alternative 1 in Issue 4).

We appreciate the opportunity to express our views on the proposed FSP. Should you wish to discuss the recognition and measurement issues addressed in this comment letter, please contact Gregg Nelson at (914) 766-0850 (gln@us.ibm.com) or Marina Sletten at (914) 766-0267 (sletten@us.ibm.com).

Sincerely,



Gregg Nelson
Vice President
Accounting Operations & Financial Reporting

cc: Richard Carroll, IBM Assistant Controller and Chief Accountant
Marina Sletten, Senior Program Manager

³ Whether that may occur will not be known until all EU-member countries adopt relevant laws and regulations.