

PricewaterhouseCoopers LLP
500 Campus Dr.
Florham Park NJ 07932
Telephone (973) 236-7204
Facsimile (973) 236-7770

March 29, 2002

Letter of Comment No: 22

File Reference: 1050-001

Date Received: 4/3/02

Mr. Timothy S. Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: FASB Proposal for a New Agenda Project: *Issues Related to the Recognition of Revenues and Liabilities*

Dear Mr. Lucas:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the Financial Accounting Standards Board's (FASB or Board) proposal for a new agenda project, *Issues Related to the Recognition of Revenues and Liabilities*. This letter and its attachment summarize our views on this proposed project and contain our recommendations regarding project priorities.

We support the addition of a project to develop a broad, principles-based accounting standard on revenue recognition. We agree with the Board's decision to devote their efforts primarily to accounting for revenue transactions and we share its view that a consideration of liability recognition must necessarily be a part of this project. In our view, the project's scope will need to include consideration of the conceptual definition of liabilities, as any accounting model for revenue transactions will need to address the accounting that would be required prior to the point in time that revenue recognition criteria are met. We acknowledge that such consideration of the conceptual definition of a liability may necessitate changes in that definition that may ultimately require revisions to other accounting guidance. For this reason, it may be difficult to narrow the focus on liabilities to those aspects that only result from the Board's consideration of revenue recognition. However, in the interests of addressing revenue recognition issues expeditiously, we encourage the Board to limit its focus on liabilities, where

possible, to those matters related to revenue transactions. To the extent issues related to liability recognition in a broader context are identified, but can be separately addressed, the Board may wish to undertake a separate project related to liability recognition. Our concern is that a broad focus on the conceptual definition of a liability and all of the accompanying implications may delay the important work that we believe must be done with respect to developing a broad principles-based framework for revenue transactions. We also believe the name of project should be changed to emphasize that it addresses liabilities related to revenue recognition.

As part of its Codification and Simplification Efforts project, the Board agreed to evaluate the feasibility of issuing standards that are less detailed and have few, if any, exceptions or alternatives to the underlying concepts. We support that view. Accordingly, we urge the Board that, to the extent practicable, any new revenue recognition model be a broad, principles-based standard rather than a detailed, rules-based one. We are hopeful that such a standard would result in accounting that reflects the substance of revenue generating activities.

In developing a new comprehensive revenue recognition model, the Board should focus on the "top-down" aspects of the project, as described in the project prospectus. That is, we believe that the Board should address the larger conceptual issues and delegate narrower issues to others, as described below. We also encourage the Board to go beyond the concepts that underlie the current model (e.g., that revenue must be "realized or realizable" and "earned"), and to study alternative notions. For example, we encourage the Board to consider the creation of value over the entire earnings cycle and how that creation of value could be reported to shareholders, rather than only focusing on the point in time that such value is close enough to the conversion to cash or other assets such that it is "realized." In short, the Board should not feel constrained by the current, historical cost-based approach to accounting for revenue transactions. That said, we acknowledge that any model developed must also consider the costs that would be incurred in its implementation and the Board must weigh those costs against the expected benefits.

Since we believe that the FASB should develop a principle-based standard that can be applied across all industries, the Board should test its ideas against a sampling of transactions currently accounted for using "industry specific" GAAP. We believe that such an exercise will be an important part of the development process. Further, because of the existence of those many models, we encourage the Board to develop a formal transition plan to address, at a high level, the impact of the new standard on specialized industry practices and, where necessary, develop a timetable and assign responsibilities for addressing current practices that are in conflict with the new standard. To facilitate this process, the Board may wish to make use of working groups comprising members with industry expertise. In so doing, the Board could delegate some of the "bottom-up" aspects of this project. Such an approach could result in a better utilization of the talents of the Board members and the FASB staff and enable the Board to leverage the talents of its constituents. We would be willing to assist in this aspect of the project, if the Board so desires.

In summary, we believe this is an important project that should be added to the Board's agenda. We look forward to supporting the Board as it undertakes this important project.

Attachment I includes responses to the specific questions contained in the proposal.

* * * * *

If you have questions regarding our comments, please contact James F. Harrington at (973) 236-7203, Brett Cohen at (973) 236-7201, or Mark Neagle at (973) 236-7204.

PriceWaterhouseCoopers LLP

**FASB Request for Comments on Proposal for a New Agenda Project
Issues Related to the Recognition of Revenues and Liabilities**

Question 1: Is there a need for the FASB or others to comprehensively address issues associated with the recognition of revenues and liabilities? If yes, should the FASB take on such an effort or defer to others? If so, to whom?

We believe there is a pressing need for a project to develop a comprehensive standard on revenue recognition. In order to develop a comprehensive model, we believe that the project's scope must necessarily also include a consideration of liability recognition, as it relates to revenue transactions. That is, the standard must address the accounting that should be applied prior to the point in time at which revenue is to be recognized. Consideration of issues related to liability recognition may well require a revision to the definition of a liability in Concepts Statement 6. We acknowledge that it may therefore be difficult to only consider liability issues that may arise in revenue transactions, however we encourage the Board to retain such a focus, if possible, in order to complete the project expeditiously. At a future date the Board may wish to undertake a separate project related to liability recognition, perhaps in conjunction with the International Accounting Standards Board.

The Board is the appropriate body to undertake the revenue recognition project. We are aware that the development of a standard on this topic is being contemplated by the International Accounting Standards Board (IASB). Regardless, we believe that the Board should move ahead with its proposed project. Moreover, because the Board appears to have completed its preparatory efforts with respect to a revenue recognition project and has already designated staff resources, we urge the Board to seek the IASB's concurrence to undertake the lead role on the project, much as it has done on the joint business combinations project.

Question 2: Is the proposed scope of such a project as described in this proposal insufficient, appropriate, or too ambitious?

We generally agree with the proposed scope of the project, as set forth in the project prospectus. Although some may view the project's scope as too ambitious, we believe that, as described in the cover letter, there is a critical need for comprehensive guidance and, given the pervasiveness of the topic, a broad scope is unavoidable.

Question 3: Should specific issues identified above or in the appendix be excluded from the scope of the proposed project? If yes, for each specific issue, please indicate whether it should be addressed as part of another FASB project, by others, or not at all and why.

We believe that the following issues identified in the appendix should be excluded from the scope of the present project. We agree that the others (i.e., those not listed below) are appropriate topics for the Board's consideration. (Note: Excerpts from the appendix are presented below in *bold italics*):

Issues Related to Both Revenues and Liabilities

1. With regard to the fundamental recognition criteria in Concepts Statement 5 that apply to all elements of financial statements:

- (a) Is the criterion pertaining to measurability operational, and if not, should it be amplified or eliminated?***
- (b) Is the criterion pertaining to relevance operational, and if not, should it be amplified or eliminated?***
- (c) Is the criterion pertaining to reliability operational, and if not, should it be amplified or eliminated?***
- (d) Should other criteria be added, and if so, what should those criteria be?***

We believe that a re-examination of the fundamental recognition criteria in Concepts Statement 5 that apply to all elements of financial statements is not necessary. In our view, the criteria are generally appropriate and, furthermore, we believe that their re-examination would unnecessarily delay the completion of this important project.

In our view, the issue to be addressed relates to the emphasis the Board places on each of these criteria. For example, if greater emphasis is placed on reliability rather than relevance, the Board should consider the types of additional disclosures that might be necessary to provide useful information to investors. That is, if reliability is emphasized, the Board may develop a model that places greater emphasis on historical cost measures. Accordingly, additional disclosure of value information may be warranted, together with attendant risks. Conversely, if the Board develops a model that emphasizes relevance rather than reliability, a model may be developed that includes greater use of value measures. In that circumstance - particularly where quoted market prices are not available - disclosures about the assumptions underlying those values, and the sensitivity of those assumptions to exogenous factors (interest rates, etc.), may be necessary.

Issues Primarily Related to Revenues

2. Should the Board eliminate the notion of earnings and the related recognition criteria so that only one set of recognition criteria would apply to all components of comprehensive income? If not, should the Board develop a conceptual definition of earnings that differs from that for comprehensive income, and develop recognition criteria that are consistent with that definition for determining which items should be included in earnings as opposed to OCI? If so, how should earnings be defined?

We believe that the primary focus of this project should be on the development of broad principles related to the recognition of revenue. This proposed issue appears to us to be one of financial statement display. For this reason, we do not believe it need be considered as part of this project. The Board may wish to debate the issue in the project on Reporting Financial Performance¹.

Question 4: Should specific issues *not* identified above or in the appendix be addressed as part of the proposed project? If yes, please describe the specific issue and indicate why it is sufficiently crucial that it should be addressed as part of the proposed project.

A response to this question depends in large part on the future direction of the project, for example, whether the new model is similar to the current one or whether it is based on entirely new concepts, such as a model that measures value creation over the earnings process. Depending upon the outcome of the Board's efforts, some of the issues noted below may be moot. While we do not wish to prejudge the Board's deliberation, if the proposed model is generally similar to the current model, we encourage the Board to include the following issues in the project's scope:

- 1) Should there be a different recognition model for sales of products vs. sales of services?

The role of services in our economy has dramatically increased over the years. Therefore, we believe that any proposed revenue recognition model should be robust enough to address accounting for both product and service transactions. Because of certain basic differences between product and service transactions (e.g., the absence of a tangible delivery, the incidence of returns), it may be difficult to develop a single model. We nonetheless encourage the Board to attempt to do so. If separate models were to be developed, the proposed standard would have to specify criteria as to when to apply the "products model" versus the "services model." We note, however, that with many transactions it may be difficult to neatly distinguish between the provision of a service and the delivery of a product. Consider a simple example: a professional photographer provides both a product and a service when he takes, develops, and delivers family portraits. Other, more complicated examples exist, particularly in the technology sector. Accordingly, in our view, a single comprehensive model is preferable, if possible.

- 2) Should the revenue recognition criteria be based primarily on the concept of a transfer of control (similar to the FAS 140 model), or on the concept of a transfer of risks and rewards, or on some combination of the two?

Under our current model, some sales of assets that are based on the concept of transfer of control have raised concerns, particularly in situations where the transferor has retained all of the risks and rewards of the underlying asset, that is, the economic substance of the transaction is a borrowing. We note that the Board is currently deliberating similar issues in

¹ Please refer to our comment letter dated September 18, 2001, in which our views on that project are presented.

its project on the consolidation of special purpose entities (SPEs) and observe that experience gained in that project could assist the Board in developing new guidance with respect to the recognition of revenue.

3) How and when should revenue be recognized in barter transactions?

Questions have also been raised about the current accounting model for barter transactions, including concerns as to the reliability of fair value estimates, as well as the substantive "business purpose" for some recent barter transactions. In light of the continuing popularity of barter transactions and the concerns noted above, we encourage the Board to include consideration of such transactions in the scope of the proposed project.

4) How do guarantees issued by the seller impact the revenue recognition process?

As described in (2) above, the substantive effect of the guarantees may be that the seller has retained most or all of the risks of the underlying asset and, therefore, the substance of the transaction may be a financing, not a sale.

- 5) How does a seller's continuing involvement (e.g., vendor financing, customer incentives, put and call options, etc.) impact the revenue recognition model?
- 6) Should the revenue recognition model specify different accounting for trading companies vs. non-trading companies? In other words, should the accounting be based on the nature of an entity's business?

Some are concerned that similar transactions might be accounted for differently under such an approach. For example, an entity that buys and sells real estate accounts for sales of real property as revenues, whereas a manufacturing entity that sells real property would record the gain or loss outside of operating income.

7) How should fair values be measured for assets and liabilities related to revenues?

We believe that the development of adequate guidance on the measurement of fair values for revenue-related assets and liabilities is critical to the successful implementation of any new standard. For example, in addition to general guidance on measuring fair values of those assets and liabilities, the guidance for this project may also need to consider:

- What type of evidence (i.e., "vendor specific objective evidence", "objective evidence", or some other measure) is needed to conclude that a separate element in a multi-element transaction can be estimated with sufficient reliability to justify recognition of revenue for that separate element?
- Should fair values be company-specific or market-based?
- Is it possible to reliably measure the fair value of a commodity supply or service contract with an extended maturity (for example, exceeding 5 or 10 years)?

- Should deferred revenue be accounted for at historical cost or fair value?
 - When consideration for a revenue generating activity is an equity instrument, how and when should the value of that consideration be measured and what are the implications of subsequent changes in value after initial measurement?
- 8) How should sales of future revenues be accounted for?

Although the focus of the consensus is on classification rather than recognition, guidance for such transactions is currently provided by EITF Issue No. 88-18, *Sales of Future Revenues*. We observe that if the Board were to revise the present definition of a liability, existing guidance for sales of future revenues would likewise require revision.

- 9) How would the proposed revenue model affect existing guidance issued by the FASB or other standard-setting bodies, particularly if the broad principles developed by the Board are inconsistent with that guidance? For example:
- Accounting by lessors (FAS 13, etc.)
 - Accounting for franchise fees (FAS 45)
 - Accounting for product financing arrangements (FAS 49)
 - Accounting by the record and music industry (FAS 50)
 - Accounting by cable television operators (FAS 51)
 - Accounting by insurance enterprises (FAS 60)
 - Accounting for sales of real estate (FAS 66)
 - Accounting for research and development arrangements (FAS 68)
 - Transfers of financial assets (FAS 140)
 - Current AICPA literature relating to specialized industries (for example, Statement of Position (SOP) 81-1 on long-term contract accounting, SOP 97-2 on software revenue, SOP 00-2 on motion picture accounting, etc.)
 - Current guidance in various EITF issues
 - Current guidance in SEC Staff Accounting Bulletin 101
 - Current guidance in the not-for-profit arena

As described in our cover letter, we believe that consideration of these issues should be a part of the “bottom-up” aspects of the proposed project. We also note that, as a part of its project on Codification and Simplification Efforts, the Board has agreed to explicitly address all related EITF, AICPA, and SEC literature as part of any new FASB standards. As noted in our cover letter, we encourage the Board to recruit others to support this aspect of the project.

Question 5: Should the proposed project, in addition to developing a new, general accounting standard on revenue recognition and revising the related guidance on revenues and liabilities in Concepts Statements 5 and 6, develop a new, general accounting standard on liability recognition?

Although the stated aim of the proposed project is the development of a new model for revenue recognition, we observe that such an undertaking will also require a re-examination of the



Attachment I

current model for liability recognition. If the Board concludes that the development of an improved revenue recognition model requires an amendment to definition of a liability found in the Concepts Statements, we believe that the Board should have the flexibility to propose an amendment to that definition. As noted above, and as set forth in the project prospectus, the Board's efforts in this area should be primarily devoted to those liabilities that may be recognized in connection with revenue transactions.