From: <u>Marie DeSiena</u> on behalf of <u>Gregg Nelson</u>

To: <u>Director - FASB</u>

 Subject:
 File Reference No. 1660-100

 Date:
 Thursday, June 18, 2009 3:28:54 PM

June 18, 2009

Mr. Russell Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
File Reference No. 1660-100

Dear Mr. Golden:

The International Business Machines Corporation (the "company") appreciates the opportunity to comment on the joint FASB and IASB (the "Boards") Discussion Paper ("DP"), *Preliminary Views on Revenue Recognition in Contracts with Customers*.

The company strongly supports the Boards' efforts to converge, simplify and clarify principles for recognizing revenue across industries. The company believes the basic framework for revenue recognition as outlined in the DP which is based on changes in an entity's overall contract position with customers is logical and practical for most industries and transactions. Furthermore, the company supports the allocation of the transaction price to contracts with multiple performance obligations based on the use of management's best estimate of selling price when observable stand-alone selling prices are not available. This approach will result in the recognition of revenue that most closely reflects the economics of a transaction.

However, the company believes that in such a diverse topic as revenue recognition, different approaches may be required to properly reflect the economics of a transaction for specialized topics such as complex service arrangements, lease accounting, insurance and financial instruments. In addition, the company feels that the following issues highlighted in the DP require further consideration:

### 1. Definition of control:

The DP bases its main approach to revenue recognition on the transfer of control to the customer, but does not directly define control. The DP leaves open the question of whether this concept of control is a legal definition or a more

principles-based definition. The examples provided tend to indicate a model focused on legal form. The company believes that the lack of a clear definition will lead to confusion and inconsistent practice and further believes a focus on legal form may generate counterintuitive results for many common transactions. Additional guidance and examples would be useful in determining whether control has been passed to the customer.

The company also believes that relying solely on the concept of control for arrangements in which a contract may not be easily allocated into distinct performance obligations, such as construction-type contracts currently accounted for under the percentage-of-completion (POC) method, may not provide decision-useful information for users of financial statements. The DP indicates that control would be passed and revenue recognized based on the terms of a contract, but the company is concerned that reliance on the concept of control in such instances may lead to a change in the way contracts are written so that legal control is passed to customers even when this does not reflect the economics of the arrangement. The company believes a risk and rewards approach to revenue recognition would be more reflective of the underlying substance of construction-type contracts.

# 2. Delivery of assets vs. providing a service:

Some arrangements involve both constructing an asset and providing a service to a customer. The DP is primarily focused on the transfer of control of a physical asset in order to recognize revenue, but also states that certain types of construction-type contracts may be considered a service (e.g. when there is a high degree of customization for the customer). If control of an asset is passed to the customer at the end of a long-term arrangement and revenue is recognized only at that time, there will be a mismatch between the economic benefits accruing to the customer during the construction period (i.e. the service provided to the customer throughout the contract) and the pattern of revenue recognition (only at the end of the contract). Although examples are provided in the DP, the company believes that additional guidance is needed in order to help determine which performance obligations are goods and which are services to ensure appropriate revenue recognition.

### 3. Discussion of costs:

The DP states that the Boards do not intend to discuss costs associated with revenue generation and that costs may only be capitalized in accordance with other existing accounting standards. However, due to the fact that a significant number of accounting pronouncements under US GAAP will be superseded by a single revenue recognition accounting standard, the company feels that it is premature to draw such a conclusion. Certain rules regarding the deferral or capitalization of

costs may inadvertently be deleted in the process. Therefore, the company believes that costs associated with revenue generation should undergo a thorough review as part of this project.

# 4. Recognition of net contract position:

Appendix C of the DP indicates that the Boards have not yet decided on whether contract rights and obligations should be recorded gross or net in the statement of financial position. Although the company agrees with the fundamental concept of calculating revenue based on changes in the rights and obligations in a contract, the company does not support these amounts being presented in the statement of financial position.

The recording of a gross contract position may lead to the recognition of items that, in the opinion of the company, would not meet the definition of an asset. For example, if an entity is performing long-term outsourcing services for a client, gross presentation would imply that the net present value of future revenues would be recorded as assets in the statement of financial position. This will also lead to an unnecessary inflation of the balance sheet that will not provide any decision-useful information to financial statement users. Furthermore, the company does not believe presentation of a net position will provide decision-useful information and will result in burdensome recognition and measurement exercises without any benefit to users.

# 5. Definition of a performance obligation:

The company proposes that the definition of a performance obligation in Chapter 3 of the DP be amended to include the concept that the performance obligation must have stand-alone customer value as a good or service. Otherwise, the company is concerned that performance obligations may be disaggregated to a level of detail which would be unnecessary and not useful to financial statement users.

For example, the company does not believe that standard warranties should be considered a separate performance obligation. They are inseparable from the product sold, and as such, have no stand-alone value. Warranties are currently accounted for under FAS 5, *Accounting for Contingencies*, and IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, because of the uncertainties surrounding the amount of warranty services that will be required. The company does not feel that a change from current accounting is required.

Thank you for the opportunity to comment on this proposal. If you have any questions, please do not hesitate to contact me at 914-766-3190 or at gln@us.ibm.com.

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