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Technical Director
Financial Accounting Standards Board
401 Merritt F
P.O. Box 5116
Norwalk, CT 06856-5116

Richard J. Schlueter Vice President & Chief Accounting Officer

8000 West Florissant Ave. P.O. Box 4100 St. Louis, MO 63136-8506 T (314) 553 2327

Re: File Reference No. 1660-100: Preliminary Views on Revenue Recognition in Contracts with Customers

We would like to take this opportunity to comment on the FASB's preliminary views on revenue recognition. We appreciate the Board's efforts to find a comprehensive approach for all revenue transactions, and agree there are elements of the current accounting that are complex and not necessarily indicative of the underlying economics. Any outcome from the project must be clearly expressed, easily understood and firmly adhere to the goal of improving financial reporting. As the Board pursues this project we offer the following suggestions for your consideration:

- The Board should be mindful of how its conceptual model translates into actual application in the future, to avoid unintended outcomes. For example, the implications of the existing concept of recognizing revenue when the earnings process is essentially complete are clear. We are unclear what the broad consequences are of recognizing revenue upon "satisfaction of a performance obligation" and why the change is necessary.
- Part of the project objective is to essentially create a common revenue recognition model from the plethora of accounting standards which have developed over time. In the end, this goal may not be practical or the cost may be too high. We are very concerned that a radical change in revenue recognition could involve a very high cost and involve reprogramming of systems around the world. Providing for some exceptions to the model will inevitably be necessary for practical reasons. While there is room for improvement, existing standards consistently applied do communicate the performance of the business, which is the ultimate goal.
- The Board must guard against evolving the model under discussion to the point where executory
 contracts (e.g., long-term sales contracts or purchase orders) are recorded in the financial
 statements prior to actual revenue generating activities. We do not support this notion, which has
 implications well beyond revenue recognition.
- Warranties included with product sales should be provided for as a cost, not as revenue. Product
 warranties in support of product sales activities should not preclude revenue recognition. There
 is no need to change this well understood concept to adhere to a theoretical model.

- Revenue recognition for multiple deliverable arrangements must be practical and avoid inappropriate revenue deferrals when the earnings process is essentially complete with respect to what has been delivered.
- Percentage of completion accounting rules should align with the substance of contractual arrangements and allow for periodic revenue recognition.

As the FASB notes in the Preliminary Views, there are myriad rules and interpretations regarding revenue recognition and this area can often be confusing for preparers and users. Therefore, as this project moves forward, the goal of improving financial reporting must be paramount. Given the variety of scenarios possible, the project needs to maintain focus on creating a model that is clearly expressed in theoretical terms, easily understood by preparers and users and capable of consistently producing practical results that accurately reflect the economics of the underlying transaction. To this end, we believe the model should allow for properly supported management judgment regarding the nature of an entity's arrangements with customers. Conversely, the FASB needs to guard against a theoretically pure but impractical, and therefore, ultimately unworkable model. We believe any simple and practical approach should maintain the long-standing and well-understood approach of revenue recognition when the earnings process is substantially complete.

For example, we are concerned with the evolution of the rules away from allowing an accounting principle to be consistently applied as a practical approach to revenue recognition, and toward a legal-form driven analysis. If a product is shipped and ownership, as acknowledged by both parties, transfers to the customer at the shipping point, revenue recognition should be allowed. The customer at that point has legal title, is legally obligated to pay, has an insurable risk, has the risk of incorporating/modifying the item into saleable product, has the risk of identifying a buyer to purchase the item at a reasonable price, and has obsolescence risk if too much product is purchased or the technology changes. We believe the earnings process for the foregoing is essentially complete but under today's legalistic application of the rules, revenue recognition is not permitted if the seller retains even a remote risk of loss for goods damaged in transit, or if the seller chooses to accommodate the customer for damaged goods, even if history shows this is unlikely to occur, or that losses have been minor or can be estimated and provided for. The risk retained by the seller is inconsequential to the overall business arrangement and revenue recognition should therefore be permitted. But the rules have become impractical, overlook the substance of the arrangement and allow no revenue recognition until the goods arrive at the customer's location. Situations such as this should be explored and a principles-based approach developed to ensure practical and accurate outcomes that remain faithful to sound accounting and reporting concepts that communicate useful information about the performance of the business. .

We are concerned an overly theoretical standard could lead to the conclusion that executory contracts — e. g., long-term sales contracts and purchase orders — should be recorded in the financial statements prior to actual revenue generating activities. Such a conclusion would serve only to gross-up the balance sheet, confuse financial statement users and create significant administrative cost and complexity while making no improvements to financial reporting. We request that the Board address this potential situation by explicitly concluding in any future documents that executory contracts are not included in the scope.

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We understand the need for guidance on extending revenue recognition over a period of time when an entity sells product warranties as a line of business. But we strongly disagree with the view that general warranties provided in connection with products sold are performance obligations requiring delayed revenue recognition. Product warranties are inherently expense activities — essentially incurring a cost to repair or replace a product in lieu of the customer incurring that cost — and should be accounted for as such. General product warranties are clearly secondary considerations and have no impact on the transfers of risk and reward to customers, or the collection of customer consideration. Thus, the earnings process is essentially complete at delivery and the cost of any follow-on activity should be reflected as a cost and offsetting warranty obligation as required today under GAAP. This is a simple and well-understood approach that reflects the economics for both parties. Existing rules already address situations where warranties are sold as separate products, or extended warranties are provided beyond those typically provided to customers.

We support the Board's apparent direction on revenue recognition for multiple deliverable arrangements to focus on selling price rather than current fair value, and also allow estimation of selling prices when not apparent through vendor specific or third party evidence. We believe both these changes will better reflect the realities of transaction pricing and the underlying relationship between buyer and seller, as well as recognize that management is qualified to develop reasonably accurate pricing estimates of undelivered items in support of revenue recognition. We encourage the Board to continue to see this area in a practical light and modify the current model, which we believe sometimes inappropriately defers revenue recognition due to the fair value approach and the prohibition on using estimates.

We disagree with the view that revenue should be deferred until the end of long-term projects because the buyer does not take physical possession of the assets in question. This approach is unreasonable and will often not be indicative of contract and transaction substance. In most circumstances, contract arrangements call for progress billings based on costs incurred plus a margin estimate. The customer has legal claim on the partially completed asset, the vendor is protected by lien rights against the customer in the event of nonpayment and both parties can demand specific performance. We believe the Board's model should look to the specifics of long-term construction contracts to allow periodic revenue recognition in those cases where the economic substance of the arrangement transfers ownership before the buyer takes physical possession of the asset.

Last the board should guard against issuing rules and requiring disclosures aimed at deterring that small number of financial statement preparers who are intent on abusing the rules. Accounting standards and disclosures should be developed on a sound but balanced conceptual basis, with clear guidance as to the Board's intent, and then allow good faith judgments by preparers and auditors in applying the rules to specific situations, without overly complex rules and onerous disclosures designed to "prove" the accounting was done correctly.

In summary, we generally support the Board's efforts to create a comprehensive revenue recognition standard. However, the Board must be mindful of how its final model applies to actual transactions to ensure reasonable, logical and substantive accounting outcomes. Executory contracts should not be recorded in the financial statements, general product warranties should continue to be accounted for on a periodic cost basis, a simple and substantive approach must be developed for multiple deliverable arrangements and long-term contact accounting should reflect the substance of the contract and provide for revenue recognition as progress payments are billed.

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We appreciate the opportunity to respond and trust our comments will be taken seriously in future Board deliberations on this issue.

Sincerely,

Richard J. Schlueter

Vice President & Chief Accounting Officer

cc: Walter J. Galvin

Senior Executive Vice President & Chief Financial Officer