From:
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 To:
 Director - FASB

 Subject:
 File Reference 1820-100

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To the Director:

Thank you for the opportunity to respond to your request for comments related to File 1820-100, the exposure draft for the proposed new revenue recognition standard. Please note that my comments are my opinion only, not those of my employer or of any organization or other group I am affiliated with.

Question 1-Price Interdependence

The issue of price interdependence should be addressed only with respect to contracts that are out of the norm, and material in nature. It appears that this provision would have to be applied to all sales of an entity, which would require the analysis and tracking of sales transactions that may be quite small, and numerous. Imagine the additional accounting required under this provision at the retail store level for a large retailer such as Wal-Mart. The additional information available will not be that useful, considering that users

- 1. Investors for publicly held companies
- 2. Banks and other creditors as well as other non-investors for companies that are privately held

Are already used to working with an existing revenue model, and have historical data to use for comparative purposes.

Question 5-Credit Risk

Revenue recognition should <u>not</u> reflect a customer's credit risk, period. As long as management discloses that revenue includes amounts that may or may not be collected, there is no reason to change from the existing practice of accounting for potential losses due to credit risk through the allowance for doubtful accounts. Very often a decision is made to sell to a questionable client, that ultimately will pay the balance due. The proposed method would actually cause revenue levels to go down initially as companies are cautious in implementing the new standard, and will ultimately cause a mismatch of revenues and expenditures.

More importantly, and more significantly, unless the IRS and most taxing authorities change their definition of revenue to match those under GAAP, there will be differences in revenue for tax purposes versus that for GAAP. To be able to account for revenue under the proposal will require significant increases in the accounting necessary to record revenue as

- 1. Every transaction would need to be evaluated, and tracked, to account for revenue based on credit risk.
- 2. A "second set of books" would now be required so that revenue under GAAP would be able to be adjusted to revenue for tax purposes.

Adjusting revenue based on credit risk is the equivalent of providing an allowance for bad debt at the point of revenue recognition. Bad debts are currently deductible at the point they are deemed uncollectible and written off, rather than the allowance being deductible. The

likelihood of cash strapped governments permitting this to accommodate financial reporting is slim.

Question 6-Time Value of Money

Adjusting the amount of revenue recorded based on the time value of money should not be required. If it is, it should only be required for material transactions, and only if the payment period exceeds one year. An alternative is to disclose the amount of accounts receivable that are over a certain term of days. Additionally, there will be the same issues as referred to in Question 5. GAAP would require the recording of interest to account for the difference between the amounts recorded and collected, while income taxes would require the full amount to be recorded as revenue. Additionally, as pass through entities generally record most interest received as "investment" or "portfolio" income, separate accounting would be required for interest income recorded for revenue transactions.

More importantly, what new, valuable information would this provide for other than the very sophisticated investor. Companies would now be recording less revenue, which is somewhat misleading. Additionally, companies would now begin to make business decisions with real economic consequences due to accounting pronouncements. Are small, unsophisticated companies going to be as willing to provide extended payment terms if they now have to adjust revenue estimates as well as revenue recorded, because a portion of their "sales" will now be considered interest income? Why should a business have to even consider this issue in determining how they do business?

Question 7-Allocation of Transaction Price

There should not be price allocation. While it is true, that many items in a contract are able to be sold on their own, often times certain items are purchased <u>because</u> they have been bundled with a larger transaction. Frequently by structuring a transaction a certain way a company may be able to get rid of certain inventory items that would otherwise remain in inventory because no one wants to buy it. It is more useful to account for the likelihood that an item would not sell through the current method of inventory mark downs. Allocation would also allow for the manipulation of revenue levels based on price allocations, and when items in a contract are actually delivered, which effects the timing of revenue recognition.

Question 11-Performance Obligations

The recording of performance obligation will create a new "phantom" liability. Changing the point at which revenue is recognized to "control over the asset" from "title transfer" on its own will change revenue levels. Most statement users (except for those of large companies) will now need to come to terms with a liability that doesn't even reflect the amount of future cash flow.

Question 13-Retrospective Application

As long as there is adequate disclosure as to the level of revenue recorded at the effective date under the old methods, the new standard should be applied prospectively only. Many existing contracts are complicated to account for, and this just adds another level of complication. Additionally what about a transaction that has been recorded in a prior year under the

existing standards extends into a subsequent year? Do we want to address changing the amounts of previously recorded transactions? What would that give us, except confusion?

Question 16-License Exclusivity

Revenue recognition should not be dependent upon whether a license is exclusive or not. In either event, the substance is the same. The following would be accounted for differently

- 1. A non-exclusive license is granted for years one to three to a customer, but no other customer licenses the product during the period, versus
- 2. An exclusive license is granted for years one to three

Granted, this example is a little extreme, but in both cases only <u>one</u> entity is using the product, with the same ultimate economic consequence to the entity, but revenue will be different for each case. Additionally, we have the same issue of revenue recognition under GAAP versus tax, as addressed in Question 5.

Question 18-Non Public Entities

The only provisions regarding how revenue is actually recorded that should apply to non-public entities should be the point at which a sale is recorded. This would provide some comparability. Additionally, many of the informational disclosures (which are not dependent on how an item is actually recorded) will be helpful. But most provisions should not be required. Many banks, other credit providers or users of financial statements understand the amounts as currently recorded. While not suggesting that the pronouncement should not be implemented to avoid users having to learn the new issues, for many provisions, what would the benefit be? A bank with an outstanding credit facility to a company selling widgets understands the effect of current and future revenue levels. With additional disclosures, many suggested changes will provide information about future performance levels and uses of cash, without the need to record "performance obligations". Additionally, as many the creditors of many non public companies are concerned for cash flow purposes about the effects of income taxes, the likely ballooning of deferred tax assets and liabilities will mask the true economic substance over form of the new methods of recording revenue.

<u>Items Not Addressed With A Specific Question By The Board</u>

1. Contract Modification

IG3-Example 2-Scenario 2-This example illustrates that revenue on subsequent contract years are adjusted down due to a new, lower price, at the subsequent renewal.

It seems unfair to require the revenue on a contract entered into in prior years to be reduced under these circumstances. Consider that at the point the original contract terms were negotiated, then existing business and industry conditions allowed certain pricing levels. However, subsequent to that date, additional competitors may have entered the market, or the industry in general had significant changes, which led to significant price reduction in future years for new contracts. Why should a company be "punished" because the market changed. If the customer honors the contract at the existing negotiated rate, then future conditions should not affect revenue. If there were no renewal, then revenue would be at the contract rate. The renewal may have been agreed to as a result of new price levels.

2. Sale of a Product With the Right of Return IG10

If a company is able to predict future returns, one can argue that revenue levels should be adjusted. However, this provision requires companies to "predict" return levels. Can the company accurately predict the future? Won't this allow for manipulation of future years revenue? What about a newly formed company in an industry with return practices. Would they be subject to zero revenue in their initial period of existence because accurate return predictions are not attainable?

3. Distinct Goods or Services-Example 9

Certainly many items of equipment is "able" to be sold separately from installation services. Almost anyone can install a dishwasher. However, outside of small contract installers, what is the likelihood that Home Depot will install a Kenmore appliance (from Sears, not a national brand)?

Just because it is possible, with its own "distinct risks" doesn't mean it should be recorded separately. How many consumers pay extra for installation services as a matter of routine, yet wouldn't have purchased the appliance <u>at all</u> if no installation was available. Distinct transactions-technically yes, but in reality no. What happened to the old adage of "substance over form"? While recognizing that revenue recognition standards need to be addressed, this is overkill.

4. Bill and Hold Arrangements

IG62 indicates whether the custodial services are a "material separate performance obligation". In certain industries, textiles, for example, the custom of the industry is to allow for X months storage for free, to reduce shipping costs. If a textile mill were not to offer bill and hold services, their ability to provide their services to many customers would go down dramatically. To now classify what for decades has been current sales revenue into current sales revenue and future storage revenue would cause some entities to raise prices so that current revenue levels would not decline, a true economic result to an accounting standard. Is this provision applicable many industries? Not in those with long standing industry practices.

5. Disclosure

Example 30 illustrates disclosure of performance obligations by not only timing, but also whether it is governmental. The only real value to me of knowing if a customer is governmental or not is with respect to outstanding receivables, as this reflects the likelihood of collection. But since collectability is addressed in how much revenue is to be recorded (Question 5), there is no need to segregate revenue by governmental or commercial. Plus, the tabular disclosure should only be required for contracts that will exceed one year.

Additional Points

In determining whether to implement many of the provisions of the Exposure Draft, the following general issues should be considered:

1. Almost all of the items directly effecting when revenue is recorded, the amount of

revenue recorded and the classification (revenue, interest, liability) will have significant issues with respect to income taxes to consider. Certain items to be considered sales revenue now will be considered interest/finance income. Not only will this affect the timing of revenue recognition, but it will also affect state allocations. State allocations include revenue by state. Under the ED, the g/l for GAAP will have differing amounts of sales for tax and GAAP purposes, with amounts states consider sales for allocation purposes differing from financial statement purposes.

- 2. Implementing the ED will require significant changes in their accounting systems, including investments in information technology
 - a. Significant investments in information technology, which many smaller companies may not have the resources or the expertise to deal with
 - b. The tracking and evaluation issues above will require greater use of estimates and subjective judgments (collectability, for example) that existing personnel may not be capable of. Additionally, many relatively small transactions will now require tracking and evaluation, often across fiscal years.
 - c. The differences in timing as well as classification of income items will be different for tax and GAAP purposes. This will
 - i. Cause the need for a second set of books to
 - 1. Allow the proper reporting of income for tax purposes,
 - 2. Allow for the proper classification of "sales revenue" recorded as interest on K-1's
 - 3. Cause significant M-1 adjustments to reflect higher revenue levels for tax purposes resulting from the need to increase revenue for tax purposes if revenue for GAAP were adjusted as a result of the time value of money (Question 6)
 - ii. Initial as well as continued increased scrutiny or audits of tax returns. The tax authorities are going to want to make sure the above components are reported properly and to reconcile revenue M-1 adjustments. Many companies will begin incurring increased accounting fees because
 - 1. Accounting firms will now be called in to handle IRS or state audits,
 - 2. Accounting firms will begin checking client provided schedules or prepare their own schedules to prove the book/tax differences before signing a return as preparer
- 3. Many of the standard changes discussed are applicable
 - a. Primarily to publicly traded companies, which will be required to report to the SEC, which wants comparability with international standards.
 - b. To privately held companies. But its applicability will be based on
 - i. To whom an entity issues statements to
 - 1. Banks, or
 - 2. Other creditors,
 - 3. Lessors
 - ii. The level of materially sized revenue transactions,
 - iii. The sophistication of its statement users, and

- iv. Whether or not current users would be satisfied with increased disclosures versus changes in accounting methodology, and
- v. Litigation. Will future legal actions hinge on the notion that
 - 1. A company/auditor followed accounting/auditing standards, but
 - 2. Failed to provide disclosures or record transactions the same way large, publicly held multinational corporations do

4. Consider

- a. How useful certain of these changes will be (particularly to many immaterial individual transactions, for example) to users. It can be argued that comparability of revenue to prior periods will be lost.
- b. How relevant these changes are at all for non-public companies or for small and/or non-sophisticated privately held companies.
- c. The cost/benefit trade off for the significant increase in requirements placed on the accounting departments.
- d. Consider the effect on
 - i. Existing debt covenants. For example
 - 1. Various liability ratios may be effected to the extreme detriment of a borrower, even though there is no change in the economic situation of an entity.
 - 2. The ability of an entity to meet reporting time requirements, especially upon implementation, may be reduced
 - 3. Banks may not consider assets recorded under this pronouncement to be "tangible"
 - ii. The ability of an entity to renegotiate covenant violations resulting from this pronouncement
 - 1. May be possible, but expensive and time consuming to negotiate,
 - 2. May be impossible for an entity to renegotiate without renegotiating other provisions of agreements that could cause significant increases in costs to satisfy. It could actually cause many small firms that are unable to renegotiate their agreements to fail.

Thank you for the opportunity to provide this feedback to the Board. Should any part of my response above be unclear, please feel free to contact me so that I will be able to make that section more understandable, and more useful.

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