October 19, 2010

Financial Accounting Standards Board
401 Merritt 7
PO BOX 5116
Norwalk, CT 06856-5116

Attn: Technical Director – File Reference No. 1820-100

Re: Comments on the FASB and IASB's Exposure Draft on Revenue Recognition

Thank you for the opportunity to respond to the exposure draft on revenue recognition. We are a Master of Accountancy class at the University Richmond. As part of an assignment for our Accounting Policy, Theory & Research class we have developed this letter.

Overall Comment:
The new proposal is principle-based, which replaces many detailed rules in U.S. GAAP for revenue recognition. The purpose is to have one standard for every revenue recognition situation that is within the standard's scope. However, one problem related to practicing the principle-based standard is that it would not be a one day process for rule-based U.S. GAAP practitioners to competently exercise their professional judgment on the new principles. The principle-based standard uses implicit language that is sometimes hard to follow when practitioners are not used to principle-based rules. For example, in paragraph 29, the draft didn't explicitly state what the following consequences would be after an entity considers related arrangements that were entered into at or near the same time, or in contemplation, of the contract. If a rule-based standard practitioner reads this, he or she might still be looking for the specific measurement and disclosure requirements for each possible consequence of the rule. Therefore, some type of transition assistance is needed to solve this problem.

We now provide responses to several of the specific questions posed in the exposure draft.

Question 2: The Boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

In paragraph 23 you describe the separation of goods and services very broadly, saying they are distinct if they could be "sold separately." In theory, most any good or service could be further separated and accounted for separately. This requirement seems to create more complexity where there shouldn't be, especially if accountants over apply this broad standard. The Standard should stress that this approach should not be over-applied.

Question 3: Do you think that the proposed guidance in paragraphs 25–31 and related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

The proposal should clarify how shipping terms should be implemented in order to align contractual terms and the recognition of revenue. For instance, under FOB shipping point control is ceded when shipped, but the ability to control the use of such items has not yet been received. Recognizing at point of shipment satisfies the contractual terms of the contract, but does not provide control yet.

Question 5: Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect *how much* revenue an entity recognizes when it satisfies a performance obligation rather than *whether* the entity recognizes revenue? If not, why?

Collectability – This issue seems to be playing a more important role and is being factored into the proposed revenue recognition standard. This is an important issue as with the recent recession and the recent changes in the market, there is greater concern over whether or not the customer does have the ability to pay.

The exposure draft refers to the customer's credit risk in recording the contract and must reduce the amount of consideration due to the credit risk of the customer. The key to identifying which contracts have been paid for and are outstanding is matching the amount of the contract. This process of reducing recorded amounts according to credit risk will cause the invoice and the recorded amount to be recorded at completely different amounts. In addition, what happens if the contract is paid in full? Another entry must be made on the books to recognize the "other income" associated with that contract. This process creates inefficiencies and much more work for financial reporting preparers without providing benefit to users of financial statements.

Question 6: Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

Requiring the time value of money to be used in calculating revenues that take place over extended periods of time is unnecessary and creates more uncertainty surrounding the financial statements. This requires more estimates and is difficult to verify the numbers that make the revenue amounts even harder to interpret. It should be sufficient to disclose revenue contracts that are expected to last over an extended period of time.

Question 7: Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

The Exposure Draft will add an unnecessary level of subjectivity into the revenue recognition process, which may lead to a decrease in comparability between companies. Paragraph 50 introduces the idea of allocating the standalone selling price of a good or service to the various performance obligations within a contract. This would involve requiring a company to obtain the relevant stand-a-lone price, either from determining the observable price of the good or service or estimating the standalone price. Both of these methods of determining the standalone price could potentially increase the costs of compliance with this new standard.

For instance, in order to estimate the observable price of a good or service, companies will not only need to determine an estimate, but will also need to obtain sufficient evidence to support their estimates. This would then continue to the audit level, where the company would need to provide sufficient evidence to the auditors for their reasoning behind the estimates. Finally, this will require significant additions to the required revenue recognition disclosures, in order to educate financial statement users on the methods used to make these estimates.

These various examples all lead to the idea of a potential decrease in comparability between companies. Each company will develop different methods to estimate the standalone price, which can make it difficult to compare the results of various companies' operations.

Question 8: Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, Topic 330 or IAS 2; Topic 360 or IAS 16; and Topic 985 on software or IAS 38, *Intangible Assets*), an entity should recognize an asset only if those costs meet specified criteria.
Do you think that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient? If not, why?

Essentially, this new cost expensing system aims to mirror the typical costing process used when accounting for contracts. However it creates two main problems. The first problem is that this new method complicates the costing process. For instance, instead of being able to simply recognize construction/contract costs as incurred and match to the corresponding revenues, companies must now derecognize assets to expense costs. This seems to add an unnecessary complication to this process.

The second problem is that certain costs, such as the costs of procuring a contract, are not eligible for capitalization. This would result in the immediate expensing of such costs, which further prevents the matching of revenues and expenses. In addition, this immediate expensing of these costs may reflect negatively on the profit margin of these companies during the early stages of the contract.

Question 9: Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation. Do you agree with the costs specified? If not, what costs would you include or exclude and why?

This paragraph introduces a significant problem. If a company breaks down a contract into three performance obligations, it does not seem logical to recognize a loss on a specific performance obligation if the entire contract is expected to be profitable. This loss may lead to unnecessary concern over the outcome of a specific contract, when in reality the loss on one performance obligation will not impact the final profitable outcome of the contract. However, we do support the recognition of a loss on a specific performance obligation if the overall contract is not expected to be profitable. This mirrors the current treatment of contract losses in ASC 605-35.

Question 10: The objective of the Boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

One constituency which seems to have a major issue with the proposed revenue recognition principle is the construction industry. While an attempt to simplify the complex framework of revenue recognition standards currently in place under U.S. GAAP is valiant, many concerns have been voiced over the potential impact a single standard for revenue recognition across all industries might create. The proposed revenue recognition standard could distort reported revenue and lead to financial reports which are less useful, meaningful, and reliable.

The nature of the construction industry is of long-term contracts negotiated between the contractor and customer, a single transaction with a single profit objective. Breaking contracts into segments or phases for the purpose of revenue recognition would lead to irregular swings in revenues and losses, and would not provide a true economic picture of the profitability of a project. Risks are inseparable within a contract, and virtually all parts of the activities under the contract are highly interrelated.

Additionally, the determination of what constitutes a "performance obligation" would be an arbitrary and subjective process, which would be inconsistently applied across contractors. The purpose of any proposed changes to accounting standards is to increase the quality of financial reporting and more accurately reflect the economic reality of financial transactions. The proposed changes would not give stakeholders better information with which to evaluate a company or industry, and would lessen consistency and comparability in the financial reporting process for the construction industry.

In the construction industry, a firm's activities are closely monitored by surety partners. Distorted and useless financial information as a result of the proposed revenue recognition

standard will likely lead to surety partners requiring a second set of books using traditional means of revenue recognition. The administrative burden of complying with the proposed standard, as well as reporting financial data under an alternative method, will undoubtedly be an unreasonable cost.
The time and cost related to implementing the new standards, which provide little or no realized value, will place a severe financial strain on companies and may even put some out of business as profit margins are currently very thin in these tough economic times.

In order to have financial statements which are a true representation of the economic relationship between the contractor and the customer, the boards should consider a separate revenue recognition model for the contracting industry. Something which resembles *Statement of Position* 81-1, *Accounting for Performance of Construction-type and Certain Production-type Contracts* would be appropriate. Progress towards the completion of a long-term contract should be measured using a model similar to the "percentage-of-completion" method. Construction projects are built and subsequently built to the owners as costs are incurred and a percentage of completion is achieved. This is the way it has always been done, and it works, so "if it ain't broke, don't fix it." Construction companies lack the basis for recognizing "performance obligations" of a contract separately, and as a result, revenue and profit margins will be recognized subjectively. This will render financial statements produced somewhat meaningless to users.

SOP-81 is a widely accepted, objective, and transparent standard in the construction industry which has worked extremely well for 30 years. Applying the current exposure draft to the construction industry would create inferior accounting standards, make reporting less meaningful, and unduly increase costs as accounting department costs would go up as well as audit fees.

From another perspective, sureties of construction companies will place increased burden and costs on construction firms as they need to request additional information from construction firms in order to make credit evaluations. Currently, sureties evaluate construction firms on a contract-to-contract basis. Under the proposal, they will need to change their evaluation process to an obligation-to-obligation basis, creating additional costs to the company.

Question 13: Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why? Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

Para 84 – We oppose retrospective application of the standard because of the complexity of most of these contracts. Most companies will not have the data on hand to go back and retrospectively report their contracts on the books with the new standard. If the standard is going to be applied retrospectively, it will take companies many hours and resources to find all the information to record the amount in accordance with the new standard. In addition, the amounts recorded could be incorrect because the information will be difficult to collect years after the fact. Contracts entered into should be recorded as is, but all contracts following the date the standard is implemented should be recorded with the new standard.

Question 18: Should any of the proposed guidance be different for nonpublic entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?

This standard should not apply to small nonpublic entities. As the IASB has already issued IFRS for SMEs which limits disclosure notices for small nonpublic entities, why should we require them to disclose all this material for their contract revenue? Nonpublic entities do not have the resources or manpower to disclose all the information required in the exposure draft. Small nonpublic entities should be given their own smaller disclosure requirements for revenue recognition.

Thank you for the opportunity to comment on the *Revenue Recognition (Topic 605) Exposure Draft.*

Respectfully submitted,

Ben Blackmer
Brian Bondurant
Stallone Mannan
Keith McCalla
Yu Wang
Kaya Washington
Dina Zhurba