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Technical Director
Financial Accounting Standards Board
407 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

File Reference No. 2011-230

Re: *Proposed Accounting Standards Update (Revised)*, Revenue Recognition (Topic 605), Revenue from Contracts with Customers

The Accounting Principles and Auditing Standards Committee (the AP&AS "Committee") of the California Society of Certified Public Accountants ("CalCPA") is pleased to provide our comments to the Financial Accounting Standards Board ("FASB") on the proposed accounting standard update.

The Committee is the senior technical committee of the CalCPA. CalCPA has approximately 35,000 members. The Committee is comprised of 43 members, of whom 56 percent are from local or regional firms, 21 percent are from large multi-office firms, 12 percent are sole practitioners in public practice, 9 percent are in academia and 2 percent are in an international firm.

The Committee generally supports the changes in the revised Proposed ASU, but has some observations and recommendations for changes.

We will first address the questions on which the Boards specifically requested comment, and then address other concerns.

Question 1: Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognizes revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

The Committee agrees with the proposal. It is a marked improvement over the prior exposure draft.

Question 2: Paragraphs 68 and 69 state that an entity would apply Topic 310 (or IFRS 9, if applicable) to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

The Committee believes that revenue is appropriately reduced by items that are an adjustment to the obligation to deliver a product, such as returns and allowances, but credit losses are just another expense of doing business and should be shown as an expense, rather than as a reduction of revenue. In addition, credit risk often does not give rise to a probable loss until well after the sale and receivable are initially recorded, and adjusting this through an "out-of-period" item affecting net revenue does not seem to have any utility, and could be very confusing.

The Committee believes that customer credit risk should be considered in determining the transaction price to be reflected in gross revenue if the entity is not reasonably assured as to the collectibility of the transaction price, and does not agree with the Boards' conclusion that it should not be considered. Failure to consider this credit risk will cause an inappropriate overstatement of gross revenues.

Question 3: Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognizes to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognize for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

The Committee agrees with the Boards' objective in its proposal, but has several reservations. The Committee agrees with the limit on the cumulative amount of revenue recognized as proposed in paragraphs 81 and 82.

However, the Committee believes that the scope of paragraph 85, which is limited to licenses of intellectual property, should be expanded. The Committee strongly agrees with the Boards' position that an entity is not reasonably assured to be entitled to additional amount of consideration from the customer until the uncertainty is resolved by the customer's subsequent sales. The Committee believes that a similar position should be taken for any additional consideration dependent on a future payment that itself is dependent upon an event that may affect the obligation of the customer or another entity to pay the selling or licensing entity. This would include sales of intellectual property, sales or licenses (not leases or transactions accounted for as leases) of other tangible or intangible property, commissions based directly or indirectly on future sales, royalties (e.g., based on natural resources extracted from property sold), and likely other types of transactions where the entity has met its performance obligation but its right to payments is dependent on future events outside of its control. Quite simply, if the customer is not obligated to accept or pay for the product, service or right, the contract required for revenue recognition does not exist and control cannot be transferred by the seller, and so there is no revenue to recognize.

As an example, the Committee does not agree with Example 14 in paragraph IG71 concerning "trailing commissions." The customer has no obligation to renew the policy, although the customer might do so, and until the customer pays the premium, there is no certainty that the entity will receive a commission.

Question 4: For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognize a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

The Committee agrees with the proposal for onerous performance obligations, except that it should apply to all onerous performance obligations, not just those to be satisfied over a period of time greater than one year. Taken literally, the Boards' proposal would eliminate any need to recognize the liability for onerous performance obligations to be satisfied over a period of time less than one year, as well as any impairment loss on assets to be used in filling those obligations, and the Committee does not see any merit to this aspect of the proposal and finds it hard to believe that that result was intended by the Boards.

Question 5: The Boards propose to amend Topic 270 and IAS 34 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial statements. The disclosures that would be required (if material) are:

1. The desegregation of revenue (paragraphs 114–116)
2. A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
3. An analysis of the entity's remaining performance obligations (paragraphs 119–121)
4. Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
5. A tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial statements? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial statements.

If all of the proposed disclosures for interim financial statements are adopted, there should be a requirement to include the type of disclosures in paragraphs 118, 124 through 127 and 129 if it has changed materially since the prior annual financial statements

The Committee believes that there is little benefit to justify the cost of the lengthy quantitative disclosures proposed for interim financial statements that cannot be achieved by disclosure of qualitative information, supplemented by quantitative information only if there has been a material change in the quantitative information since the most recent annual financial statements.

Further, the Committee believes that the quantitative disclosures should be required only for the most recent period for which a statement of comprehensive income and a statement of financial position are presented, unless the prior financial statements presented have been restated. The disclosures, whether quantitative or qualitative are lengthy and only the most recent period disclosures are likely to be of interest, and little useful purpose is served in repeating disclosures that are readily available in prior financial statements

Question 6: For the transfer of a nonfinancial asset that is not an output of an entity's ordinary activities (for example, property, plant, and equipment within the scope of Topic 360, IAS 16, or IAS 40), the Boards propose amending other standards to require that an entity apply (a) the proposed guidance on control to determine when to derecognize the asset and (b) the proposed measurement guidance to determine the amount of gain or loss to recognize upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement guidance to account for the transfer of nonfinancial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

The Committee agrees with the Boards' proposal.

Transition: The Committee recommends that the FASB permit early adoption (paragraph 131), similar to the current position of the IASB. The U.S. is undergoing an economic recovery and businesses are finding new customers and new types of sales arrangements. They may find it convenient to adopt the ASU when it is published, rather than adopt an accounting policy that it will have to change in several years. In addition, many entities may find it relatively easy to adopt the ASU when it is published and prefer to act immediately. Still others may find that the provisions in the ASU resolve uncertainties in their existing accounting policies and prefer to change to the more certain provisions of the ASU. The Committee does not believe it should be required to maintain the *status quo* for potentially several years in the face of improved standards. Comparability among entities may be illusory as there is diversity in practice, and there will likely be diversity under the proposed ASU. Further, in the period between publication of the ASU and implementation, entities will be obligated to disclose and quantify the effects of the new standard on their financial statements under Codification paragraph 250 -10 SEC Topic 11.M., and this could go on for several years; entities should have the ability to avoid the disclosures by just adopting the new standard.

Additional Transition comment for consideration:

The Boards have required retroactive application, with some practical expedients to reduce the burdens of restatement. While the Committee supports the effort to permit practical expedients, the Committee recommends that retroactive application be required only for contracts that have not been fulfilled at the transition date. There are two reasons for this. One is to simply avoid the tedium of what can become a very complex restatement. The second is to avoid distortion. Entities often modify business practices to achieve revenue recognition objectives, and can be expected to do so in the future when faced with the proposed ASU. Retroactive restatement will cause new rules to be applied to transactions that cannot be modified and were structured to comply with

different old rules, which can cause any consistency expected to be achieved to be illusory.

OTHER COMMENTS:

Consideration payable to a customer: "Frequent flyer" programs: It appears that the Boards intend that an entity's transaction price be reduced for the value of loyalty programs, including frequent flyer programs. Example 24 at paragraph IG79 is helpful in this regard; however, it deals with an obligation that is already denominated in dollars. Awards in frequent flyer programs and certain other loyalty programs (e.g., hotel, rental cars, cruise lines) are usually not denominated in dollars, but in some other manner like "miles" or "points." It would be very helpful to explain, in text, examples or both, how the value of programs not denominated in dollars should be quantified. For example, for frequent flyer programs, is it average seat selling price, discounted price, foregone revenue, cost, incremental cost, etc. This has been a controversial area, and the Committee is concerned that without more specific guidance, significantly diverse practices will persist.

Bill-and-hold arrangements: The Committee suggests addition of two additional criteria for determining that the customer has obtained control of a product subject to a bill-and-hold arrangement:

- The bill-and-hold arrangement is requested by the customer.
- Timing of payment is not dependent upon delivery to the customer's site.

These are consistent with existing criteria. Accounting for these types of transactions has been problematic in the past, and The Committee believes that the accounting rules should be overly explicit to avoid any risk of misinterpretation.

Real estate sale transactions: The proposed ASU would eliminate the separate rules for real estate sales currently in Subtopics 970 through 978. While the Committee believes that the existing real estate accounting rules have been very useful in avoiding the accounting abuses that originally gave rise to the rules and would prefer to see them retained, it recognizes that the Boards do not share this view. However, Example 7 at paragraph IG64 highlights a significant flaw in what the Boards are doing. Residential real estate has never been subject to percentage-of-completion accounting in the U.S.; revenue and profit recognition occurred only after the sale was closed for a number of reasons including inherent uncertainty concerning whether the buyer will or intends to honor the contract and also be able to secure financing. One only need to look at the current state of the real estate market to appreciate that the uncertainties that existed almost forty years ago when the accounting rules were first written still persist.

The Committee recommends that a specific provision be added following paragraph 31 that an entity's performance obligation on sales of residential real estate cannot be considered to be met until the closing of the sale of the real estate. Real estate, particularly residential real estate, really is different from other products. (There may be legal structures that would overcome this position, but they would be so rare that they should not be considered.)

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We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Sincerely,

A handwritten signature in black ink that reads "Howard Sibelman". The signature is written in a cursive style with a large, prominent initial 'H'.

Howard Sibelman,
Chair
Accounting Principles and Auditing Standards Committee
California Society of Public Accountants