

March 12, 2012

Technical Director Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, CT 06856-5116

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The Accounting Principles Committee of the Illinois CPA Society (Committee) appreciates the opportunity to provide its perspective on the Proposed Accounting Standards Update (Revised), *Revenue Recognition (Topic 605) Revenue from Contracts with Customers* (Revised PASU). The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of the Committee are outlined in Appendix A to this letter.

In previous comment letters on this and on other proposed updates we have expressed our concerns with respect to the ability of auditors to attest to the reliability of management estimates and judgments in areas ranging from Level 3 fair values to exposures on remote contingent liabilities. Our concerns have increased in view of the rapid pace with which accounting standards have been changing. We believe that users' ability to place reliance on the faithful representation of underlying economics expressed in the financial statements is inextricably tied to their belief that auditors have attested to the reliability of those representations. The ability to audit not only management judgments and estimates made currently, but those that would have been made in the past for those standards that will be implemented retrospectively is critical to the ultimate usefulness of financial statements. While the Boards have not yet specified the effective date for this and other proposed updates in process, we believe that that the effective date for public companies should be not less than two full years from the date of issuance to allow preparers to document applicable judgments and intentions that would come into play in the retrospective application of the new standard.

In our January 2012 comment letter to the Financial Accounting Foundation on its *Plan to Establish a Private Company Standards Improvement Council* we noted the FASB's "willingness to take action in private company issues as part of the standard setting process" specifically citing the revenue recognition project as one in which reporting by private companies is specifically addressed. We applaud the Boards for their consideration in this Revised PASU and agree with the extent of the exemptions contemplated and with a delayed effective date.

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?

We agree with reservations. In our response to Question 3 of the previous version of this proposed update and in our response to Question 8 of the Preliminary Views document, we raised concerns over use of the term "control" in determining when a performance obligation is satisfied. The determination of satisfaction will be subject to considerable judgment and second guessing in some situations. We recognize the Boards have done their best to expand the concept of "transfer of control" to capture the sorts of questions we raised in communicating our view that transfer of control is just one aspect of the satisfaction of a performance obligation, however we continue to have concerns in this area.

Our past experience dealing with the complexities of transfer of control in accounting for derecognition of assets leads us to believe complexities will continue to arise in revenue recognition under the Revised PASU. The boundary between leasing and selling will continue to be fruitful ground for transaction structuring. For example, the transactions described in IG40 et seq. dealing with forwards and options leave much room for transaction structuring. Selling prices can be manipulated and the idea that one transaction can be structured at selling price plus \$1, another at selling price less \$1 and those two would be accounted for differently seems to place us in the same "bright line" environment the Boards have been struggling to avoid.

We also note the Boards' approach to bill & hold arrangements continues to focus on transfer of control to the exclusion of transfer of risks and rewards of ownership as well. While control might encompass the concept of transfer of rewards, we believe that risks must be addressed as well. If the Boards believe that the existence of significant risks would be embodied in some unfulfilled performance obligation (e.g., an implicit insurance obligation for goods transferred under bill & hold but for which the seller has risk of loss in the event of fire or flood) this belief should be added to the discussion in IG54 concerning custodial obligations.

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?

We agree. In our response to Question 5 in the previous version of this proposed update as well as in our comment letters to the Boards addressing impairments of financial instruments we have consistently stated our belief that information about management's propensity to accept risk and the manner in which it deals with the risks accepted is valuable information; it allows users to assess management's performance and compare performance across entities. In these earlier letters we objected to the "burying" of that information either in net revenue or in net interest income. Accordingly, we agree with the proposed presentation as it appropriately captures management's judgment at the time it enters into a revenue arrangement and appropriately discloses that information to users.

Some might argue for separation of the losses that are assessed at the time the arrangement is made from losses that arise later due to changes in the economic environment. We believe the relatively short time frame between satisfaction of a performance obligation and collection of amounts owed should suggest that management's judgments at the inception of the arrangement would contemplate most of those economic uncertainties and any later impairments of accounts receivable are more appropriately reflected as contra-revenue rather than operating expenses.

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?

We agree. In our response to Question 4 of the previous version of this proposed update we stated our agreement with the Boards' proposal that variable consideration be recognized to the extent those amounts are reasonably estimable. As noted in the introductory paragraph we have also consistently questioned the Boards' push for fair value reporting without apparent regard for the reliability of those amounts and the ability of auditors to attest to them. We believe that this "cap" on the amount of revenue to be recognized will effectively limit this amount of estimated variable consideration to one that is verifiable and, hence, more reliable.

We do note however, the potential for misunderstanding in this area. Consider paragraph 55(a) which states that one could estimate the transaction price based on expected value. However, the variable consideration under the contract is clearly intended to be capped by the amount specified in paragraph 81. We expect that there will be some level of conflict in practice between the application of paragraph 55(a) and the constraint imposed by paragraph 81.

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?

We disagree. In our response to Question 9 of the previous version of this proposed update and in our comment letter on the Preliminary Views document, we objected to the concept of onerous contracts. While we recognize that this treatment is consistent with current practice related to "loss contracts" in construction accounting, we believe it is a concept that is outdated.

Contracts are normally not considered onerous at their inception; they become onerous due to changes in circumstances that arise later, such as changes in the prices of labor or materials. They can also become onerous because of management's inaccuracy in its original estimates of the amounts of labor and material required or the efficiency with which they will be employed. In any case, we believe those factors do not result in losses of the current period but losses related to future periods which should not be accelerated to a current period. Costs of labor and materials increase; that is a normal business occurrence. Those increases lead one contract to a loss position while another contract is merely less profitable. The Boards should not allow management to take a "big bath" in the current period for the former any more than it would allow management to protect its future profit margins by recording the increased costs of the latter in the current period. We do not see a basis for giving special treatment to so-called onerous contracts.

Additionally, we disagree with the concept that a contract containing multiple performance obligations overall might be profitable but if one performance obligation in that contract is not, the reporting entity should recognize a loss for that onerous performance obligation. We recommend the Boards require, in this situation, that the overall contract be re-evaluated and any loss first be allocated among remaining performance obligations.

Finally, the PASU appears to be silent on the treatment of any subsequent change in the assessment that a performance obligation is onerous. We recommend the Boards specify that any liability recorded pursuant to a determination that a contract is onerous, should not be adjusted until all performance

obligations under the contract have been satisfied consistent with the concept that asset impairments are not reversed, but are recognized when the related asset is realized.

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 disaggregation 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.

We agree in part. Disclosures in interim financial statements are needed to update annual information and provide users with the ability to assess an entity's performance throughout the year. However, we have noted over the years the growth in the size and complexity of interim financial statements as well as the cost of its preparation in terms of the time spent by management and its staff to accomplish that. In our response to Question 12 of the previous version of this proposed update with respect to disaggregation, we recommended the Boards specify that such disaggregation be based on the method used by the Chief Operating Decision Maker (CODM) to manage the entity and that other disclosures be consistent with the level of detail provided to the CODM. To the extent the above information is based on the information routinely used by the CODM, we believe the requirement to provide it at interim periods is operational as it does not add to costs already incurred to prepare and analyze information for use internally. We again recommend the Boards consider specifying the information prepared be consistent with that used by the CODM and by segment managements.

We also call to the Boards' attention an apparent inconsistency in IG 75 Example 19. Paragraph 117 requires disclosure of "cash received" as part of the reconciliation of contract balances. Example 19 however does not include this disclosure but instead includes only "cash sales". The example should be adjusted to disclose cash received in accordance with the disclosure requirements.

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?

We agree. As stated in our response to Question 3 of the preliminary views document which limited the concepts to an entity's ordinary activities, "...we believe the concepts underlying this [preliminary views] document will necessarily be applied by analogy to transactions not part of an entity's 'ordinary activities'. For example, a real estate developer who sells a building to a customer in the ordinary course of business may also sell its headquarters building. This latter transaction does not generate revenue as it would not be considered a sale of goods or services in conjunction with the entity's ordinary activities, but it will likely generate a gain or loss. The concepts underlying the contractual model in this document can also be applied to that situation."

We appreciate the opportunity to offer our comments.

Sincerely,

Jeffery P. Watson, CPA

Chair, Accounting Principles Committee

Scott G. Lehman, CPA

Vice-chair, Accounting Principles Committee

APPENDIX A

ACCOUNTING PRINCIPLES COMMITTEE ORGANIZATION AND OPERATING PROCEDURES 2011-2012

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee's comments reflect solely the views of the Committee and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to fully study and discuss exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

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