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We appreciate the opportunity to comment on the Discussion Paper – Preliminary Views on Revenue Recognition in Contracts with Customers.

Air Products serves customers in industrial, energy, technology, and healthcare markets worldwide with a unique portfolio of atmospheric gases, process and specialty gases, performance materials, and equipment and services. Air Products has annual revenues of \$10 billion and operations in over 40 countries.

Our Equipment and Energy segment designs and manufactures cryogenic and gas processing equipment for air separation, hydrocarbon recovery and purification, natural gas liquefaction (LNG), and helium distribution. Equipment is sold worldwide to customers in a variety of industries. Revenues from equipment sale contracts are recorded primarily using the percentage-of-completion method, based on labor hours incurred to date compared with total estimated labor hours.

Support Convergence

We commend the FASB and IASB on their continued joint efforts towards convergence. More specifically, we support the objective of establishing principle-based guidance which simplifies and reduces the number of standards on revenue recognition.

Contract Asset/Liability Focus

We do not object conceptually to a contract-centered asset and liability focus in an effort to help more precisely define, while remaining consistent with, an earnings process approach. However, we do not necessarily see significant value-added with the change in focus. We find the concept of recognizing revenue on the basis of increases in an entity's net position in a contract to be confusing. In comparison, existing guidance under the earnings process approach is well understood by preparers and users of financial statements and has served us well in evaluating transactions for revenue recognition (i.e., persuasive evidence of arrangement, fixed or determinable fee, delivery or performance occurred, collectability reasonably assured).

Contractual Rights

We agree the model should focus on the contract. Further, we believe it is critical that the resulting revenue recognized reflect the enforceable contractual rights established by the contract (e.g., the customer's right to require performance, the supplier's right to bill/collect).

As per the definition of a contract included in the Preliminary Views document, a contract exists when an agreement between two or more parties creates enforceable obligations between those parties. It follows that the enforceable contractual rights of the parties should be evaluated and reflected in the revenue recognized. We are concerned the proposed model does not always give proper consideration to reflecting contractual rights, but rather focuses on who controls the asset e.g., via physical possession.

Long-term Construction Contracts

In particular, we are concerned as to how the proposed model would be applied to long-term construction contracts. Under the preliminary model, revenue would not be recognized in the construction phase if the customer does not control the asset being constructed. Where the use of percentage-of-completion accounting would, therefore, no longer be allowed under the proposed model, we believe the financial statements would not reflect the economic substance of our equipment sale transactions.

The Preliminary Views document acknowledges it may be more difficult to determine whether a good or service is being transferred when an entity promises to build an asset for a customer (construction-type contract). We believe this difficulty will translate into inconsistent application and reduce comparability.

Based on the examples included in the Preliminary Views, we are concerned certain long-term construction contracts may not meet the criteria for revenue recognition over the contract term due to lack of transfer of physical control of the asset when the economics of the contract indicate that an earnings process has occurred. As an example, for our equipment sales contracts, equipment is designed and manufactured in accordance with customer requirements, including engineering to design to the customer's unique specifications. We receive nonrefundable milestone payments from the customer; however, the customer may not have the right to take physical control of the work in progress at any time, title/risk of loss may not transfer until physical delivery, nor may the customer terminate for convenience at any time and receive an asset in exchange. Performance occurs as per contractual terms in accordance with the customer's unique specifications and milestones.

We believe, however, that revenue recognition over the construction period is, in this type of arrangement, appropriate given the guaranteed revenue being earned over time as the contract performance is executed. Nonrefundable milestone payments are received and contracts include provision for cost/profit coverage in the event of contract termination. We are concerned that the basic underlying business arrangement, the contract between the buyer and seller, is being ignored in favor of a physical test. Identical transactions could be accounted for differently based on the physical location of where we choose to do the work (in the field or in one of our manufacturing facilities) and not on the economic substance.

Modify Guidelines

We suggest the proposed guidelines be broadened and/or clarified to specify alternative criteria for long-term construction contracts. The transfer of control of the asset during the construction period should not be required. Revenue should be recognized over the life of the arrangement in proportion to the stage of completion of contract activity, when consideration is guaranteed, as evidenced by contractual terms, including receipt of nonrefundable milestone payments and contract termination provisions.

For the users of financial information to benefit, we suggest focusing on the substance and economics of the transaction. Activities are undertaken on the customer's behalf in accordance with customer specifications. The performance obligation is satisfied over time via performance in accordance with enforceable contractual rights. Accordingly, revenue should be recognized over time.

Summary

We strongly support convergence efforts and the objective of a principle-based approach. While we agree with the objective of reducing industry-specific standards and exceptions, this should not prohibit providing somewhat specific guidance for substantially different transaction types, without being overly prescriptive or necessarily industry specific. We also firmly believe that where an enforceable contractual arrangement exists, it should govern the accounting for the transaction.

The advantage of percentage-of-completion accounting for long-term construction contracts is the resulting decision-useful information. Deferral of revenue and resulting earnings volatility would not provide information useful to users, nor portray the economic substance of these transactions. Principle-based guidelines are needed which result in revenue recognition consistent with the substance and economics of the arrangement, including long-term construction contracts. Revenue on these contracts must also reflect the substance of the arrangement, with emphasis on reflecting the associated enforceable contractual rights.

We appreciate the opportunity to provide comments on the Discussion Paper and would be pleased to discuss our views further with you.

Respectfully,



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