



Via Email

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Re: FASB and IASB Discussion Paper, *Preliminary Views on Revenue Recognition in Contracts with Customers* (FASB File Reference No. 1660-100)

The Investors Technical Advisory Committee (ITAC) welcomes the opportunity to provide input on the FASB and IASB Discussion Paper on Revenue Recognition. Our input is from our perceptions as users of financial statements with the goal of improving the financial reporting process<sup>1</sup>.

**General Comments**

The ITAC commends the Boards and staffs of the FASB and IASB for their efforts to develop a comprehensive revenue recognition, measurement and reporting standard for the benefit of investors and other users of financial statements. Financial reporting for revenues is not only the single most important standard setting area in terms of the potential effect on the statements of managers' revenue recognition and measurement decisions, but it has also been a source of continual challenges and problems, including

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<sup>1</sup> This letter represents the views of Investors Technical Advisory Committee ("ITAC") and does not necessarily represent the views of its individual members, or the organizations by which they are employed. ITAC views are developed by the members of the Committee independent of the views of the Financial Accounting Standards Board ("FASB") and its staff. For more information about the ITAC, including a listing of the current members and the organizations in which they are employed, see [http://www.fasb.org/investors\\_technical\\_advisory\\_committee/itac\\_members.shtml](http://www.fasb.org/investors_technical_advisory_committee/itac_members.shtml).

fraud and manipulation of the statements.<sup>2</sup> Thus, we encourage the Boards in their efforts to design an entirely new standard for revenues that will meet the challenges of twenty-first century business practices. We believe that this discussion paper provides an important first step in the process.

The ITAC believes that a clear and comprehensive objective for revenue recognition and measurement should be established and communicated by the FASB and IASB. The objective should be supported by a set of robust principles that can serve as benchmarks for determining whether the objective has been met. Such principles have been a hallmark of other recent projects that the ITAC believes have resulted, or show promise in resulting, in substantial improvement in financial reporting, for example the Financial Statement Presentation project still underway and the completed Statement No. 157, *Fair Value Measurement*. For discussion purposes, we would propose the following:

1. The *objective* of revenue recognition is to recognize, measure and report the expected increase in the value of an entity's net assets resulting from a transaction between the entity and a customer that requires the transfer of goods and/or services to the customer.
2. To achieve this objective, the entity should apply the following principles:
  - a. At inception of the contract:
    - (1) Recognize and record all assets associated with the contract by the nature of the asset (completeness);
    - (2) Recognize and record all liabilities/obligations associated with the contract by the nature of the obligation and by the term of the transfer of the goods or services if more than one transfer is included in the contract (completeness);
    - (3) Measure all assets and liabilities/obligations by either (1) the contract price **or** by the (2) **estimated fair values of the assets and liabilities/obligations if the fair values of the components differ from the amounts implied by the contract price** (accuracy).

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<sup>2</sup> The potential effect on the single most commonly cited number in the financial statements, net income, of a small change in revenues is profound, and the major reason that revenue reporting has been subject to continuing instances of fraud and manipulation. For example, for the majority of companies that comprise the S&P 500 index, the long-term average of the ratio of reported earnings to revenues, sometimes referred to as the return on revenues, is in the range of 5 percent to 10 percent. Hence, an increase in revenues of 1 percent may well result in an increase in earnings of 20 percent, depending upon the nature of the cost structure of the company.

- b. Following inception of the contract:
- (1) Record any changes in assets and liabilities/obligations (including remeasurements that result from changes in estimates) when the changes occur, uncertainties are resolved, or improved information is available (accuracy, timeliness).
  - (2) Recognize revenues (losses) when transfers of goods or services to the customer or other changes have occurred and related contingencies and claims are resolved or terminated resulting in an increase (decrease) in the entity's *net asset position* in the contract (accuracy, timeliness).

Our responses to individual questions and related comments will reflect these general principles and concepts.

### **Single Revenue Recognition Principle – Contract: Implied Obligations**

#### **Question 1**

*Do you agree with the Boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?*

The ITAC agrees with the Boards' general proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability. We believe that a single revenue principle will be applicable to the full range of entities, whether they are engaged as producers of manufactured goods, financial products, services, or any other revenue generating activities.

#### **Question 2**

*Are there any types of contracts for which the Boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?*

The ITAC believes that the approach put forward in this proposal, together with our suggested objective and principles, will be equally applicable to all types of contracts, including those for transfer of financial products or the provision of financial services such as lending, leasing, purchase and sale of securities, insurance, underwriting, and other activities. We believe that past distinctions among different types of contracts to provide goods and services were arbitrary at

best. For example, the difficulties faced by standard setters when trying to distinguish between insurance contracts (i.e., contracts to transfer certain stated risks and related rewards from one party to another) from derivative contracts (that also transfer or reshape distributions of risks and rewards) made clear the deep economic similarities in the two classes of contracts despite their separate historical development processes. **We do not believe that superficial differences in the historical evolution of revenue contracts should be used as a basis for allowing different financial reporting, recognition and measurement for such arrangements. Thus, we strongly support the development of a single robust revenue recognition standard which will be applied without exception to the entire spectrum of such transactions.**

The proposal states in paragraph S11(a) regarding some financial instruments:

*In the Boards' view, because of the potential volatility in the value of those contracts, the proposed revenue recognition model might not always provide decision-useful information about them.*

As we indicate indirectly in part 2(b) of our own set of proposed principles, above, changing supply and demand across the entire spectrum of goods and services are a continuing feature of markets, and the resulting changes in prices of assets are an inherent and fundamental part of the business environment. We believe that a core purpose of financial reporting is to uncover and disclose these changes in a sufficiently timely manner to enable investors to use the information to inform their investment decisions.

As an example, the markets of the last few years have been characterized by heightened and rapidly changing concerns about risk and declining prices for many assets, and, as a consequence, this recession has been broad-based, deep, and applies to many sectors. We believe that preparers' application of a revenue recognition standard following the Board's proposed approach, in conjunction with our suggested principles, would have provided more timely and decision useful information regarding economic changes to originally contracted assets and liabilities and their values to the users of the financial statements. Thus, we do not believe that any such distinctions based upon the volatility of prices should be made between different types of contracts. We would be concerned about the scoping out of any revenue contracts, especially at such an early stage in the development of the proposal.

To the contrary, we believe that any revenue proposal should recognize this most basic factor of continuous change markets and make provision in the revenue recognition and measurement requirements. Specifically, sellers should be required to recognize such changes as they occur through remeasurements of assets and liabilities in executory or other contracts. Given the importance of this topic to

financial reporting transparency we would encourage the Boards to construct the provisions, including related guidance and disclosure, so as to be as robust as possible.

We share the Boards' concern in paragraph S12 regarding certain types of revenue recognition practices that have arisen in the past, absent a transfer of goods or services to a final customer, such as increases in the value of inventory. The usual justification for such recognition has been that the inventories can be sold forward and that prices for such assets are readily available on a daily basis. However, we believe that the revenue recognition objective and principles should apply fully in this case. Until such time as the inventory (1) has been sold, (2) has been transferred to either the final customer or to a storage facility designated by the purchaser, and (3) the seller has been irrevocably relieved of all claims, warranties, and other obligations with respect to the inventory, we believe that it would be premature to recognize revenue as such on the inventory. Our concern is that for such inventories substantial (physical) risk related to the condition of the inventory is retained by the seller until final delivery occurs. Such risk, in effect, renders forward sales of the inventory contingent transactions.

### Question 3

*Do you agree with the Boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.*

Paragraph S10 provides the definitions of both a contract and a customer:

*A contract is an agreement between two or more parties that creates enforceable obligations. Such an agreement does not need to be in writing to be considered a contract. A customer is a party that has contracted with an entity to obtain an asset (such as a good or a service) that represents an output of the entity's ordinary activities.*

We believe that this definition of a contract is general and applicable to the full range of revenue generating activities. The same is true of the definition of a customer. However, we believe that the definition should be clarified to state, "A contract is an agreement between two or more parties that creates enforceable **and implied** obligations." Many of the commitments made in such transactions are clearly enforceable, as evidenced in the recent market meltdown. However, these commitments may be variously written, oral, i.e., explicit, or implied. In fact, many of the largest losses incurred by financial services firms have been associated with implied rather than explicit obligations. Such commitments are not limited to financial services contracts but extend to the full range of business arrangements,

and include the usual warranties and post closing support, but also failed products and services that imperil other customer relationships and reputational risks.

### **Performance Obligations– Transfer of Risk and Return**

#### **Question 4**

*Do you think the Boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.*

Paragraphs S17-18 address performance obligations:

*An entity's performance obligation is a promise in a contract with a customer to transfer an asset (such as a good or a service) to that customer. That contractual promise can be explicit or implicit.*

*When an entity promises to provide a good, it is promising to transfer an asset to the customer. When an entity promises to provide a service, it similarly is promising to transfer an asset even though the customer may consume that asset immediately.*

We believe that the definition and explanation provide a good basis for consideration. However, as we have indicated above, we believe that if the definition is to be sufficiently general, comprehensive and clear to result in consistent and comparable recognition of liabilities and obligations under the contract, substantial tightening is required. For example, would all automobile manufacturers have felt compelled to recognize all potential warranties, guarantees, and other commitments related to the sale of the vehicle at the inception of the contract? Would issuers of CDOs (collateralized debt obligations) have understood the necessity to recognize in the balance sheet their implied obligations, including the various puts associated with the transactions?

We believe the definition can be enhanced by focusing on the full distribution of risks and returns associated with a revenue transaction. We believe a sale has not occurred unless all the risks and returns associated with the asset or service either have been transferred to the buyer or have been fully and completely recognized in the balance sheet and income statement of the seller. Delivery and legal transfer of title of the asset are not sufficient recognition criteria if risks and rewards are

retained by the seller but not fully recognized as performance obligations.<sup>3</sup>

We would encourage the Board to craft a clear and rigorous standard that compels transparency in the complete range of commitments and obligations incurred in companies' revenue contracts. If this is achieved, we believe that comparability and consistency in revenue recognition both within and across firms will be substantially enhanced.

### Question 5

*Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?*

The ITAC agrees that performance obligations in a contract should be separated on the basis of when the entity transfers the promised assets to the customer. **The ITAC also believes that obligations should be separated as well by the nature of the obligation for significant deliverables.** Obligations to provide such different goods and services as hardware, warranties and maintenance on hardware, software upgrades, helpdesk services, and the like represent substantially different activities with differing risks and implications for revenue recognition.

In many cases stated price lists are publicly available but substantial discounts may be provided to certain customers based upon volume of purchases or other consideration. These arrangements may have significant implications for profit margins and the long-term viability for particular revenue streams. Thus, we believe that such discounts and other customer consideration should be separately reported and would provide significant decision useful information for users.

### Question 6

*Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?*

The ITAC agrees that an entity's obligation to accept a returned good and refund

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<sup>3</sup> We would note that it is common practice in investment firms engaged in mergers and acquisitions, and who invest their own capital, to carefully evaluate the adequacy of recorded liabilities for employee pension benefit obligations, product warranties and service obligations, contingent obligations (e.g., the tobacco industry), insurance liabilities and the like. Indeed, the examinations conducted in many such investments under consideration may be substantially more rigorous than the analyses performed in support of current financial reporting requirements, and include much more rigorous economic evaluations.

the customer's consideration is a performance obligation, frequently one of such magnitude as to eliminate the profits realized from an activity as we have seen recently with certain financial products issued in the financial markets. Where such rights of return or other guarantees and warranties exist, either explicitly or implicitly, they are necessary to induce a customer to purchase the good in the first place and, thus, should be considered an essential condition of sale. In some industries, such as publishing, the terms may result in 20 per cent or more of the goods being returned to the seller, a highly material proportion of the revenue and should be considered as part of the overall economics (and later changes) associated with the revenue earning process. Entities should disclose the history of returns to investors, but should use this information to determine whether the risk and returns were transferred to the customer, a necessary condition to record the revenue.

### **Question 7**

*Do you think that sales incentives (for example, discounts on future sales, customer loyalty points, and "free" goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?*

We have touched on this briefly in question 5. The ITAC agrees that any such customer consideration should be separately recognized and measured as performance obligations. It can be assumed that such consideration was a necessary cost of business incurred to induce the customer to enter into the contract for the goods and services in the first place. It is important for investors to be able to understand the nature of the revenue generating processes in a company and the implications of those processes for future profitability. A good example of the potential effects of such consideration can be found in the highly competitive automobile industry in recent years.

## **Fulfilling Performance Obligations and Recognizing Revenue**

### **Question 8**

*Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.*

We believe that the question of when an asset has been transferred to a customer, and the performance obligation has been satisfied, is a critical one in revenue recognition, and a major source of difficulty with financial reporting in the past. Consequently, we commend the Boards for their particular attention to this issue.

“Control” as a criterion in financial reporting has proven highly problematic in some areas and seems to invite game playing by sellers in order to escape the apparent strictures of the concept. If the goods are still in the physical possession of the seller, are incomplete and continuing to undergo production, and because of their incomplete state cannot currently be employed in the operations of the customer, is it reasonable to deem that control of such goods has passed to the customer, even if the contract so specifies, and that the seller is entitled to recognize revenue as a result? We do not believe the seller is entitled to recognize revenue and have explained below.

The ITAC believes that additional conditions of severability and usability should be placed on the notion of transfer in order to use control as a criterion for revenue recognition. We think these conditions should be added to the definition regarding transfer and control.

We will provide a very simple example to explain our thinking. Allied Equipment enters into a contract to build a fleet of 500 delivery trucks for Speedy Worldwide Delivery Service. Let us consider some scenarios:

1. Allied, which uses a large scale production line system to manufacture vehicles for a variety of customers, completes the drive train assemblies for all 500 trucks.
2. Allied completes the first 100 of the trucks and delivers them to Speedy. Speedy receives the trucks, inspects them, and sends notification of its acceptance of the trucks to Allied.

In scenario 2, we would feel comfortable agreeing that transfer has occurred and control of the 100 trucks has passed to Speedy. Hence, 20 per cent of the performance obligation has been satisfied under the contract (assuming no other related performance obligations have been agreed to).

In contrast, regardless of how the contract is worded, we would be concerned if revenue were to be recognized by Allied under scenario 1. Allied has agreed to deliver trucks, not merely drive train assemblies. Without further work, Allied has not satisfied its obligation to Speedy to deliver trucks under the contract, nor will Speedy receive the product for which it has contracted. Presumably, Speedy, which is in the delivery business, has no use for the drive train assemblies in their current state. Thus, it is not clear to us what control would mean in this context and how the recognition of revenue could be justified. Allied and Speedy may well have entered into an agreement for funding by Speedy of the construction of the trucks over the life of the contract. However, we would maintain that the financing of the transaction (with billings and the like) should be a completely separate financial

reporting matter from the revenue recognition under the contract, or the transfer of assets to the customer.

Now, let us consider a third scenario:

3. Allied contracts with Speedy to build only the drive train assemblies for Speedy. In turn, Speedy has contracted with Vintage Vehicle Bodies to complete the construction of the delivery trucks. Allied completes the 500 drive train assemblies and delivers them to Vintage, which inspects them and informs Speedy they are satisfactory. Speedy notifies Allied of its acceptance of the assemblies.

In scenario 3, Allied agreed only to supply drive train assemblies, not trucks. Hence, when the assemblies are delivered and accepted, Allied's obligation under the contract has been terminated, absent other guarantees, warranties, or obligations. Thus, we would agree that Allied is entitled to assert that transfer has occurred and that it is entitled to recognize the revenue under the contract.

In both scenarios 2 and 3, Allied has severed or terminated its obligations under the contract and Speedy has received the goods for which it contracted and has accepted them or its agent has done so.

In those circumstances such as scenario 1, in which a lengthy period of time, even years in some cases, may pass before the goods are completed and ready for transfer to the customer, we believe it is more economically meaningful for sellers to recognize the accretion in the inventory account with sufficient disclosure of the terms of the contract(s) so that investors will be able to evaluate the production activities of the seller. The offsets to the accretion would presumably be payments for goods and services incurred in the production. When the goods are finally completed and transferred to the customer, the revenue can then be recognized along with the cancellation of the performance obligation, assuming that acceptance of the product is not contingent upon another variable.

Also, we realize that many sellers will wish to "smooth" their revenue streams consistent with past practice. Some will maintain that it is not possible to obtain financing for long-term projects in the absence of recognized revenues. However, we believe that those lenders involved in financing such construction will be sufficiently sophisticated and knowledgeable in the long-term construction activities of their borrowers and their history of completed projects that they will not require superficial "revenue recognition" practices to induce them to enter into financing for such transactions. Indeed, they may well be more concerned with the financial strength of the customer for the constructed assets, the ultimate source of financing.

### Question 9

*The Boards propose that an entity should recognize revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.*

The ITAC would agree that an entity should recognize revenue only when a performance obligation is satisfied. We have discussed our views on various aspects of this at length above. Our main concern with the notion of satisfaction of a performance obligation is with the passage of control as a criterion.

We proposed an example above that maps some of the types of concerns that might arise and what conclusions we would reach about whether the performance obligation has been satisfied.

### **Fair Value of Transaction – Reasonable Representative - Use of Stand-Alone Selling Prices**

### Question 10

*In the Boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.*

- (a) *Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?*
- (b) *Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?*
- (c) *Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.*
- (d) *Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement*

*approach you would use.*

We will consider parts (a) through (d) jointly.

As we have stated in our general comments, we believe that performance obligations should be measured initially at the transaction (contract) price **unless** the estimated fair value of the obligation or asset differs from the transaction price. That is, if, for example, the estimated future costs (present value of the future cash outflows to satisfy the obligation) should exceed the contractual obligation, then the present value of the expected costs should be used. Similarly, if incontrovertible evidence that a decline in the obligation has occurred, e.g., if the seller forward contracts to purchase materials at a cost below that previously estimated under the contract, then the obligation should be reduced.

We believe similar adjustments should be applied to assets recorded under the contract if the estimated consideration to be received is believed to have decreased (perhaps owing to a decline in the credit worthiness (financial distress) of the customer).

Our concern here derives from numerous practices current in business in which the assets or liabilities recognized fail to accurately represent the underlying economics of the contractual arrangement. For example, where third party reimbursement is the practice in the provision of medical services, the amounts initially recorded by the “seller,” the provider of medical services, may not be reflective of the amounts reasonably expected to eventually be received. This has more to do with establishing grounds for future demands for increases in reimbursement rates than with any reasonable expectation for current payment. In other cases, where the possibility exists for future adjustment to contractual terms, e.g., cost overruns in government contracting, an incentive exists for sellers to initially understate expected costs (obligations) in order to gain the contracts.

**Thus, we believe that a form of baseline reality check needs to be established in revenue reporting to ensure that the amounts recognized and measured are reasonably representative of the ultimate expected contractual cash flows.** We would suggest that at a minimum, the seller should be able to demonstrate that the transaction (contractual) amounts do not differ materially from estimates that would be developed using Statement No. 157 estimation. That is, to the extent possible, amounts recognized and measured under the contracts should reflect market (exchange) inputs. Where special terms and consideration have been granted, those items should be separately recognized and measured, as we have indicated above, using appropriate Level 3 estimation. Level 3 estimation and disclosure would provide a measure of robust recognition and measurement currently lacking in much if not most revenue recognition. We

also believe it would contribute more than any other change to improving the overall quality of revenue recognition and measurement.

### **Question 11**

*The Boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (for example, selling costs) are included in the initial measurement of the performance obligations. The Boards propose that an entity should recognize those costs as expenses unless they qualify for recognition as an asset in accordance with other standards.*

- (a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?*
- (b) In what cases would recognizing contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.*

We agree that the entity should include any amounts charged to a customer to recover the costs of obtaining the contract in the initial measurement of the performance obligations associated with the contract. It is essential that the accounting and reporting for the transaction be complete, faithfully represent the actual economics of the transaction, accurate, and timely in recognition and remeasurement. Thus, any payments or other consideration expected to be received (or otherwise specified in the contract) as well as any payments expected to be made (or otherwise specified in the contract) should be completely and accurately recognized and measured. Consequently, we concur fully with the Boards' decision in this case.

We agree that any costs incurred in obtaining the contract, whether direct sales commissions, indirect promotional costs, consideration awarded to third party agents, or other costs of any kind associated with obtaining the contract should be expensed immediately upon obtaining the contract. Although such charges result in a benefit to the entity, the benefit loses all future value once the contract has been obtained and the customer has entered into the arrangement.

We expect that this change, with which we fully concur, would affect a broad range of costs that traditionally have been capitalized as assets and deferred and amortized over (potentially) decades, even in some cases long after those responsible for obtaining the contracts have departed the entity and the customer

has moved to another provider. Deferred acquisition costs (DAC) for obtaining insurance contracts come immediately to mind.

Such deferral of costs amounting to enormous sums in many cases is nothing more than a smoothing mechanism to veil the potentially unfavorable effects of reporting completely, accurately, and in a timely fashion, the economic consequences of transactions. Thus, we strongly encourage the Boards to maintain their position of requiring the prompt expensing of costs whose future benefit ceases to exist at inception.

### **Question 12**

*Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's standalone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?*

The ITAC agrees that in general the transaction price should be allocated to the performance obligations based upon the entity's standalone selling prices of the goods and services underlying those performance obligations. Of course, this assumes that the reference standalone selling prices reflect the prices of the substantial proportion of the entity's actual sales transactions for the individual goods and services, and not, for example, stated, and possibly stale, list prices that are seldom realized by the entity in practice. It also assumes that a complete recognition and measurement of all such performance obligations occurs, i.e., that significant liabilities are not ignored in the initial recognition of the revenue transaction.

That is, as we have indicated in our general comments, we believe that the measurement of the individual assets and performance obligations should reflect the most accurate estimate of the fair value, i.e., the present value of the expected future cash inflows and outflows under the contract.

### **Question 13**

*Do you agree that if an entity does not sell a good or service separately, it should estimate the standalone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?*

We agree that even if an entity does not sell a particular good or service separately, it should estimate the standalone selling price of that good or service for purposes

of allocating the transaction price by using third-party evidence of selling price in standalone sales. **Our concurrence is based entirely on the presumption that the principles that we have proposed in our General Comments, and have discussed extensively above, are adhered to in the estimation process.** That is, the estimation must accurately and completely reflect the present value of the expected cash flows generated by the sale of the individual components.

A case in point would be the sale of a laptop by the manufacturer with an operating system that is also produced by the manufacturer or by a third party under an exclusive licensing arrangement. The laptop cannot be operated without the operating system. However, the two, the hardware and the software, emerge from two very different development and production processes with different economic costs and implications to the seller. The provision for post sale upgrades, corrections, and patches to the operating system are frequent concomitants to the sales transaction. The system may also require substantial post sale assistance by the seller to the customer for satisfactory use of the laptop. Similar issues arise for the hardware and hardware options.

It is a truism that sellers must understand the performance of the products (and their components) they are selling and the customer's satisfaction with those products. The only way that this can occur is if the seller is required to separate the components and track their performance over time. However, what is true for the seller is of equal or greater importance to an investor who must compare the patterns of revenue generation, profitability, and risk exposure across companies within an industry, and across industries.

### **Conclusions**

The ITAC commends the Boards for addressing the substantial and long-standing problems with standards for recognition and measurement of revenue by all entities. We believe that a single robust set of reporting principles, based upon complete and up-to-date recognition and measurement of all assets, liabilities, risks and rewards associated with the revenue contract, are an essential foundation for a standard that can meet the challenges of twenty-first century business activities. Should the Boards or staff wish additional information regarding our views, please contact either the undersigned or any member of the ITAC.

Sincerely,



Rebecca McEnally  
Member, ITAC