

***NORTHROP GRUMMAN***



**Kenneth N. Heintz**  
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October 22, 2010

Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856-5116

Subject: File Reference No. 1820-100: Revenue from Contracts with Customers

Dear Director:

We appreciate the opportunity to provide our comments on the proposed Exposure Draft entitled, *Revenue from Contracts with Customers* (the “Exposure Draft” or “Proposed Standard”) issued by the Financial Accounting Standard Board (“FASB”) and International Accounting Standards Board (“IASB”) (collectively, “the Boards”). The intent of our letter is to address our position on the Exposure Draft, from our perspective as a leading provider of systems, products, and solutions to U.S. Government and commercial customers, also taking into consideration the other FASB and IASB convergence projects currently underway.

We would like to express our appreciation for the changes that the Boards have made to the Exposure Draft in response to our Discussion Paper comment letter, most notably the addition of contract cost language and the concept of continuous transfer. As we will subsequently indicate, there are still changes that need to be made in order to make the uniform model workable for the Aerospace and Defense industry, but we acknowledge that the changes made to date have brought us much closer to one standard of general use.

In our industry, we regularly enter into long-term construction/production type contracts for highly customized products/services to a relatively limited set of customers. These contractual relationships are typically memorialized in extensive contract documentation, have significant customer involvement and interaction over the contract term, and typically involve products that cannot economically be provided to anyone other than the original customer. The guidance established by FASB Accounting Standards Codification (“ASC”) 605-35, *Construction-Type and Production-Type Contracts* (ASC 605-35) and 912, *Contractors* –

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*Federal Government* (ASC 912) contains both revenue and cost guidance for these unique attributes of our business that do not exist elsewhere in U.S. Generally Accepted Accounting Principles (“U.S. GAAP”) and thus would be eliminated if the new guidance were to be adopted in its proposed form. This existing guidance has stood the test of time, having been in use for nearly thirty years, and has served the industry well in providing investors and others with decision useful information. The solidity of the existing guidance is further demonstrated by the fact that it has not resulted in any significant restatements or regulatory actions to amend or interpret its provisions since adoption.

We are concerned that adopting a single revenue recognition approach for all contracts with customers may provide less decision useful information for our investors. In particular, our current accounting model reflects the way our long-term contracts are bid, negotiated and managed and aligns with the economics of our business. Furthermore, based on our reading of the Exposure Draft we have concerns that applying the Exposure Draft may have unintentional effects for our industry and require companies in our industry to substantially change how they record revenue. If the final standard does not reflect revisions to the cost guidance to allow for deferral of production, learning curve, and bid and proposal costs, then it is likely that companies will move to an input method of revenue recognition (e.g., cost-to-cost) for units of production contracts, to avoid reporting results that do not reflect the economics of the contract. Furthermore, this and other proposed changes might compel companies in our industry to supplement their financial statements with non-GAAP disclosures. We believe this would lead to an inundation of supplemental disclosures for investors, on top of the already voluminous disclosures that the Exposure Draft requires. This will not provide decision useful information to investors, nor do we think that the Boards intend for companies to feel the need to provide supplemental information. Therefore, we reiterate our request that long-term construction/production type contracts be exempted from the proposed model and that the current ASC 605-35 and ASC 912 guidance be retained.

If a scope exception is not granted for long-term construction/production type contracts, we request clarification and/or additional interpretive guidance to resolve the areas of concern expressed in this letter. Absent such clarification, we believe the proposed model will result in information that is not decision useful for our management or shareholders and will require companies with long-term construction/production type contracts to use an accounting model that does not appropriately reflect the economic substance of their contracts.

**Contract segmentation and identification of performance obligations**

We agree with the Boards’ principle of price interdependence, and how the standard describes the application of this principle for when to combine contracts and how to account for contract modifications. However, we do not agree with how the standard describes the application of this principle for when to segment a contract. The Boards provide qualitative guidance to determine when contracts should be combined, yet the segmenting guidance is indicative of a prescriptive test. We believe the conditions of this test will result in excessive segmenting for U.S. Government Contractors, because as presently drafted the contract

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management function, which is significant in our industry, is not considered when separating a contract into its hypothetical discrete tasks, phases, and deliverables. Using the proposed guidance, contracts in our industry would often be segmented by the Contract Line Item Number (“CLIN”) within the contract, because certain of these elements can often be sold or performed by another entity. We believe that the best solution is to integrate the guidance on contract segmentation and identification of performance obligations into one step, as this will allow entities to take the contract management function into consideration and will result in accounting that is consistent with the overall economics of their contracts.

### **Continuous transfer of control**

We do not believe that the Exposure Draft provides sufficient guidance for determining when continuous transfer of control exists, especially for contracts with unique complexities. We feel that there are numerous contractual circumstances not addressed in paragraph 30(d) of the Exposure Draft that further support the continuous transfer model and we request that the Boards include additional indicators to ensure that the use of continuous transfer is supported for these situations as well. Furthermore, the Exposure Draft appears to favor the output method of accounting for arrangements with continuous transfer. We understand that this bias was unintentional, and request that the Boards clarify through revised language that both input and output measures can be acceptable methods of accounting for continuous transfer, depending on the circumstances.

### **Contract Costs**

We appreciate that the Boards have included guidance in the Proposed Standard for capitalization of contract costs that are incurred in satisfying performance obligations. However, we believe that there are a few areas in the currently proposed guidance that would lead to financial results that are not indicative of the substance of the contractual arrangement. It is particularly critical that these concerns be addressed, given that the Proposed Standard would eliminate ASC 605-35 and ASC 912, which specifically support deferral of certain costs related to work-in-process on long-term construction/production type contracts, capitalization of learning curve costs, and capitalization of bid and proposal costs that are explicitly allowable under the contract. We ask that the current accounting guidance for these three key areas be retained, as it appropriately reflects the economic substance of contractual arrangements in our industry.

### **Variable Consideration**

We agree that an entity should recognize revenue on the basis of an estimated transaction price when appropriate, but we do not agree with the Boards’ proposed method of estimation. We believe that management’s best estimate is the most accurate way to record variable consideration. A probability weighted approach may often lead to recording revenue at an amount that is not a possible outcome under the contract. The probability weighted approach adds unnecessary complexity to the assessment of the transaction price for a result that in

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many cases would not accurately reflect the transaction price and underlying economics of the transaction or provide decision useful information to an investor. Furthermore, we believe that the criteria in the Exposure Draft for when you can estimate variable consideration are too simplistic and restrictive.

### **Onerous Performance Obligations**

We do not agree with recording an onerous liability at the performance obligation level at the inception of a contract where the overall contract is profitable. Our main concern is that using the proposed allocation methodology will result in recognition of contract losses at inception that have no correlation to contract performance. We argue that where losses at inception are indicated for certain performance obligations within an otherwise profitable contract, there are most likely significant interdependencies between the performance obligations within the contract such that they should be combined for revenue recognition purposes. We recommend that the onerous test be revised to be performed at the contract level if performance obligations within an otherwise profitable contract appear to indicate an onerous condition at inception.

### **Time Value of Money**

Conceptually, we agree with adjusting the contract consideration where appropriate for the time value of money. However, in many contracting situations contract payment terms are designed to mitigate the contractor's exposure to certain contract performance risks, and the existence of up-front or lump sum payments are not necessarily indicative of a financing mechanism. To this end, we request that the Boards develop this guidance to be more principles based, allowing an entity to take into account factors such as the customary contract terms and conditions intended to deal with the range of risks inherent in the contract that may not be indicative of a financing component. We agree that in situations where the terms and conditions differ substantially from the norm and such conditions indicate that a financing component is present, the contract price should be adjusted. If the Boards do not make revisions to this guidance, we will be required to apply time value of money to thousands of contracts, where there was no intent to finance.

### **Transition**

We believe that retrospective adoption of the Exposure Draft would be impractical for most entities in accordance with ASC 250, *Accounting Changes and Error Corrections*. We suggest that the proposed guidance be applied prospectively for contracts with customers entered into after the effective date of the standard. Other major revenue recognition standards have been applied on a prospective basis, including most recently Accounting Standards Update (ASU) No. 2009-13, *Multiple-Deliverable Revenue Arrangements*, and ASU No. 2009-14, *Certain Revenue Arrangements that Include Software Elements*. To address the Boards' concern regarding preservation of trend information about revenue, we suggest that entities provide meaningful supplemental qualitative and quantitative disclosures.

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Alternatively, we suggest that contracts at a specified level of completion (e.g., greater than 50%), be excluded from retrospective adoption.

### **Disclosures**

Given that the proposed model will apply across all industries, we do not believe prescriptive disclosures are beneficial given the substantial differences across business models. We suggest requiring disclosures at a principles based level as this would allow different industries to provide relevant information to their respective financial statement user groups, while maintaining the principles based intent apparent in the rest of the Exposure Draft. Further, we do not believe that many of the proposed disclosures provide decision useful information. For instance, the tabular reconciliation is merely a reconciliation of account balances with no other utility. We suggest replacing the volume of required quantitative disclosures with dynamic decision useful qualitative disclosures that companies can supplement with quantitative data about an entity's contract activities, as deemed relevant. We also urge the Boards to take the cost-benefit of the proposed disclosures into consideration. In an effort to reach one accounting model we feel that the Exposure Draft contains many non-substantive quantitative disclosures that will inundate the reader with data that is not decision useful, as discussed above. If the Boards do not elect to adopt a principles based approach with respect to disclosure requirements, then at a minimum we ask that the Boards perform detailed field studies across many industries to fully understand the cost impact of the required disclosures.

### **Implementation Guidance**

Currently, the implementation guidance only covers a small sample of transactions that are in most cases too simplistic to be useful. Following are several improvements that we feel are necessary in order to make a uniform model operational for all industries:

- Revising examples to ensure that the facts, circumstances and results are not skewed towards one extreme or the other as these have limited utility to preparers
- Greater representation of industry specific examples for each topic, as there are many industries that will have unique application issues such as Aerospace and Defense
- Separate implementation guidance for products and services as they have unique considerations

We have also provided fact patterns that we think would make useful implementation guidance, in our response to question 14.

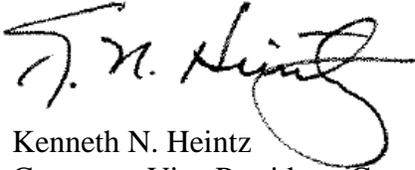
If the Boards do not choose to carve out long-term construction/production type contracts from the Exposure Draft, and decide to move forward with the model as proposed, we respectfully request that consideration be given to clarifying or modifying the guidance therein with respect to the areas of concern outlined above and in our answers to the ensuing

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questions. For the convenience of the reader, we have included the original Exposure Draft questions in the Attachment followed by our response to each question.

We appreciate the opportunity to comment on this Exposure Draft, and would be pleased to discuss further our company's perspective.

Respectfully,

A handwritten signature in black ink, appearing to read "K. N. Heintz". The signature is fluid and cursive, with a large loop at the end.

Kenneth N. Heintz  
Corporate Vice President, Controller and  
Chief Accounting Officer

Attachment

**Replies to Questions for Respondents**  
**Exposure Draft:**  
***Revenue from Contracts with Customers***

**Question 1: Paragraphs 12-19 propose a principle (price interdependence) to help an entity determine whether to:**

- (a) combine two or more contracts and account for them as a single contract;**
- (b) segment a single contract and account for it as two or more contracts; and**
- (c) account for a contract modification as a separate contract or as part of the original contract.**

**Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?**

**Combination Criteria**

We agree with the Boards' principle of price interdependence, and how the standard describes the application of this principle for item (a) above.

**Segmentation Criteria**

We do not agree with how the standard describes the application of the pricing interdependence principle for item (b) above. We do not think that the Boards' intent for item (b) as described in paragraph 37 of the Basis for Conclusions was translated into operational guidance in the Proposed Standard. Paragraph 37 states that "The principle for combining contracts has an implication for segmenting a contract," but the determination of when to combine and segment are described inconsistently within the Proposed Standard. Paragraph 13 provides qualitative indicators to consider when combining, while paragraph 15 is indicative of a prescriptive test, describing two conditions that if met, require an entity to segment.

We believe that in many cases, the segmentation criteria as currently drafted in paragraph 15, will lead to unintended results, such as excessive segmenting for many entities including U.S. Government Contractors such as ourselves, which will result in accounting that does not match the economics of our contracts. The importance of the contract management function, which has been set forth in paragraphs 56 through 59 of the Basis for Conclusions in connection with the determination of performance obligations, will not even be considered if a contract must first be segmented by its discrete tasks, phases, and deliverables, which in many cases would be by the Contract Line Item Number ("CLIN") for our contracts with the U.S Government, because certain of these items may be sold or performed by another entity. This unintended result is largely due to paragraph 15(a), which requires segmentation if "the entity, or another entity, regularly sells identical or similar goods or services separately." To avoid a proliferation of segmenting we believe that the significance of the contract management function necessary to ensure the successful oversight and execution of the process needed to manage the risk elements within and across the various elements of the contract needs to be incorporated into paragraph 15. We acknowledge that the Boards address this concept in the "Identifying Separate Performance Obligations" section of

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the guidance, but as currently drafted the model does not clearly articulate the differentiation between segmenting contracts and determining performance obligations.

Paragraph 38 of the Basis for Conclusions provides the purpose for including segmentation guidance in paragraph 15, and it indicates that it was to simplify the assessment of the scope and to prevent an entity from having to re-allocate changes in a variable transaction price to an entire contract. We believe that there are several ways the Boards can resolve the operational difficulties that have resulted from the segmenting criteria (e.g., item (b) above), while still achieving its objective from paragraph 38. We believe that the best solution is to integrate the guidance on contract segmentation and the determination of performance obligations, which will eliminate the unintentional effect of excluding the importance of the contract management function from the segmentation guidance.

To achieve effective integration of the two concepts, we suggest that you remove paragraphs 15, 16, and 23(a) from the Proposed Standard as these criteria contribute to a segmenting result that does not generally match contract economics. We suggest instead that you provide some suggested indicators for when a good or service would have a distinct function and profit margin to include in a separate paragraph between paragraphs 23 and 24, possibly including an indicator that allows an entity to take into consideration the overall economics of the contract. The inclusion of indicators will eliminate confusion among preparers and help prevent the development of diversity in practice while retaining principles based guidance.

We agree with the method of allocating the transaction price in paragraphs 50 through 52 and feel that this guidance remains relevant with the changes suggested in the preceding paragraph. Rather than allocating subsequent changes to all performance obligations, we believe that entities should be able to apply judgment in determining which performance obligations the subsequent changes are related to and allocate based on this assessment. In the event that a change cannot be discretely identified, the change should be allocated to all performance obligations. This integrated solution will streamline the segmentation evaluation into one step while maintaining the pricing interdependence principle and Boards' objectives, and thus resolve many of the existing application issues.

Other alternative approaches to effectively integrate these concepts would include modification of the segmentation criteria to include more qualitative factors similar in nature to the combining criteria provided in paragraph 13, or at a minimum clarifying the application of paragraph 15(a) to incorporate the importance of the contract management function as previously discussed. If the Boards elect to revise the segmentation criteria, we would suggest inclusion of the following indicators:

- Some or all of the deliverables were bid and negotiated separately, such that the customer could accept or reject them on an individual basis.
- The performance (and/or profit) of some or all of the deliverables does not impact or rely upon the others.
- The revenues and costs associated with some or all of the deliverables can be separately identified.

## **Replies to Questions for Respondents**

We believe that the above are qualitative indicators of price interdependence, consistent with the combining approach, and will permit preparers to use judgment when determining how and when to segment a contract.

### *Contract Modification Guidance*

We agree with how the standard describes the application of the pricing interdependence principle for item (c), contract modifications. To eliminate any potential confusion and diversity in practice, we recommend that you revise paragraph 18 to state “An entity shall apply the proposed revenue requirements to a contract modification only if the conditions in paragraph 9 and 10 are met.” Oftentimes, contract modifications with the U.S. Government are initially committed based on oral communication of the scope requested but without final agreement of the total price of the work. Adding a reference to paragraph 9 would clarify that a contract modification can also be in the form of an oral or implied contract when not all of the final terms are agreed.

**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?**

We generally agree with the Boards’ proposed guidance on identification of performance obligations, which is conceptually consistent with current U.S. GAAP related to long-term construction/production type contracts. However, we believe using “distinct” to define “separate” performance obligations may lead to confusion and inconsistent application.

### *Identification Of Contract Performance Obligations Based On Contract Deliverables Produces A Better Result*

We recommend that the Board consider the value of a “top-down” approach for identifying performance obligations based on what is intended by the parties to the contract. The Exposure Draft currently requires the identification of tasks and the separation of those tasks as performance obligations (a “bottoms-up” approach) based on whether the elements of the contract are distinct or have separate identity, without regard for the intent of the contracting parties or an analysis of whether the distinct tasks only create value for the customer when they are performed together to produce an integrated result. We find this to be more confusing and complex than the current approach in ASC 605-35. A “top-down” approach focused on the unique, customized product or service that meets the customer’s specifications would more appropriately separate the contract into groupings of tasks that are integrally linked by the contract management function to provide distinct product or service deliverables that the customer would more appropriately evaluate as performance obligations under the contract.

In our industry, we rarely perform on contracts where the contract elements are distinct tasks that do not depend on being combined with other contract elements. By focusing on the key contract deliverables, as viewed by the customer, in the determination of performance obligations companies would naturally separate their contracts into performance obligations based on their logical components and these would better portray the economic substance of the contract and thus provide information that is more decision useful. We believe that the application of this principle in our

## **Replies to Questions for Respondents**

industry would produce more meaningful performance obligations, and more appropriately highlight the critical role that the contract management function plays in the performance of our contracts. We believe it is otherwise inherently difficult to promulgate guidance that would allow the economic substance of the multitude of existing and future revenue arrangements to be properly reported in all cases.

### *Clearer Guidance Needed To Address Contract Management Function*

We believe the Boards have appropriately recognized that, in many instances, it does not make sense to separate long-term contracts into multiple performance obligations due to the significance and importance of the over-arching contract management function in managing the pervasive contracting risks inherent in the complex and interrelated nature of the underlying tasks. This is highlighted in the application guidance of paragraphs 56 through 59 of the Basis for Conclusions.

However, as noted in our response to question one, we believe this concept should have more prominence in the Proposed Standard, as interpretations of “distinct profit margin” could vary widely and the addition of guidance therein related to the contract management function is helpful in applying the proposed guidance in our industry. Further, we believe that this guidance should apply to all of the segmentation (if this concept survives) and performance obligation requirements to ensure that contracts for highly complex deliverables and interrelated risks are accounted for consistently and that the resulting accounting treatment provides decision useful information to investors. In our industry, the contract management function is a critical oversight function that manages the complexity and risks inherent in delivering an integrated solution to our customer and is the “glue” that links together the various sub-elements within the contract to achieve the overall contract objective.

For example, as part of a contract that involves the highly complex detailed design and integration of mission system equipment, we may do relatively straight-forward tasks that could be done by many parties, such as procure laptops to use in conjunction with the mission system. However, we would not view our procurement of the laptops as a separate performance obligation, because the contract management effort required to ensure that the mission system software is properly developed, tested and integrated into the laptops to accomplish the overall mission system application requirements relies on the successful acquisition of the laptop devices. The risks inherent in all of these tasks are so interrelated that they cannot be separated since the utility to the customer is the overall integrated solution. More specifically, the customer is looking to us to manage its entire project and deliver a fully integrated system that works effectively and the procurement of laptops, itself, has no stand-alone value to the customer.

In our industry, we believe that the successful performance of the contract management function is a critical element in the overall success of most of our contract or program related activities, and as such, it is a critical competitive discriminator that helps us succeed on our existing contracts and win new contracts. It is not a distinct good or service that can be sold separately, but rather it is an integral part of the overall product or service that we provide and a critical element in the revenue recognition process for our contracts and programs.

**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**

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### **service has been transferred to a customer? If not, why? What additional guidance would you propose and why?**

We would like to express our appreciation for the Boards' incorporation of the concept of continuous transfer of control into the Proposed Standard. However, as currently drafted the proposed guidance is not sufficient for determining when control of a promised good or service has been transferred to a customer in circumstances where there are unique complexities, such as those involved with long-term construction/production type contracts for highly customized products/services provided to a relatively limited set of customers. These contractual relationships are typically memorialized in extensive contract documentation, with significant periodic customer involvement and interaction over the contract term and typically involve products that cannot economically be provided to anyone other than the original customer. The factors addressed in paragraph 30(d) encompass some but not all of the factors necessary for determining when revenue recognition under the continuous transfer of control model would be appropriate. To better articulate the concept, we recommend including the following items as characteristics of conditions where "the design or function of the good or service is customer specific" when viewed from the customer's perspective:

- Highly customized product or service
- Extensive design and development effort for the product/service (as opposed to duplicating an identical asset or performing a routine service)
- The customer's ability to be continuously and intimately involved in the design and development of the product/service over the course of the contract
- Unique customer base
- Alternative use of product/service for no or few other customers
- Long-term period of performance
- The inclusion of contractual protective rights such as termination for convenience
- The contract requires payments, which, except in unusual circumstances, are effectively nonrefundable (such as progress or milestone payments as work is performed)

We would also recommend incorporating the explanatory language from paragraph 30(d) as currently drafted, as parenthetical notes to the above proposed indicators, where applicable.

#### *Measuring Progress Using The Continuous Transfer Model*

It is our understanding that the Boards intended to be flexible with regard to an entity's use of an input or output method of accounting for continuous transfer contracts. We do not feel that the Boards' intention is clear in the Proposed Standard and request that the Boards clarify through revised language that both input and output measures can be acceptable, depending on the circumstances. ASC 605-35-25 does a good job of communicating neutrality through the following language:

- Paragraph 71: "Both input and output measures have drawbacks in some circumstances...The use of either type of measure requires the exercise of judgment and the careful tailoring of the measure to the circumstances."
- Paragraph 81: "All three of these measures of progress [term of cost, unit of work, or values added] are acceptable in appropriate circumstances."

## Replies to Questions for Respondents

We believe that the concept of continuous transfer will be more operational if changes are made in the final standard to allow entities to select methods that reasonably depict how control is transferred.

**Question 4: The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.**

**Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?**

We agree that an entity should recognize revenue based on an estimated transaction price in the appropriate circumstances. However, we believe the conditions outlined in paragraph 38 are unnecessarily restrictive with respect to these circumstances.

### *Definition Of Estimated Selling Price Should Be Refined*

Very often in contracts where the goods or services to be provided are dependent upon customer design or function, or are usable in limited applications for a relatively small number of specialized customers, the fee or margin component of the selling price of the product or service is variable and dependent upon factors that allow for estimation of the ultimate value to be realized on the contract. In such circumstances, an entity must use an estimated selling price (including this variable fee) to make the economic decision of whether or not to accept the contract. Generally, contractors would not be willing to enter into a contractual relationship to produce a good or service if they could not reasonably estimate the expected value to be received for their efforts, including a fee or earnings component. In such circumstances, estimation of the selling price expected to be realized on the contract is an essential element of the transaction.

Considering the above, we believe that the criteria in paragraph 38 are too simplistic and restrictive. We believe the language should be expanded to fit circumstances that are more common. We would suggest changes to paragraph 38 as follows:

“An entity shall recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. The following are indicators of circumstances in which the seller can reasonably estimate the transaction price:

- (a) the contract’s terms and conditions are such that it is clear that a key element of the contract price is variable and dependent upon conditions that may be in the customer’s or seller’s control;
- (b) the contracting entity has previous experience with similar types of contracts or with the customer in similar contractual arrangements, and the contracting entity's experience is relevant to its ability to estimate the revenue ultimately expected to be realized on the contract;
- (c) the contract contains objective criteria that are useful in estimating the variable consideration under the contract.”

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We also suggest changing the introductory language in paragraph 39, to state “Other factors to consider that may reduce the relevance of an entity’s experience,” because we feel the current language is too restrictive.

### *A Probability Weighted Approach Would Be Inconsistent With Underlying Economics Of The Transaction*

Further, we do not agree with a probability weighted approach in determining the amount of variable consideration. We understand that the Boards continue to believe that this methodology appropriately reflects the conditions at the reporting date, but we continue to have concerns with this approach. When estimating the transaction price for contracts with variable consideration, the use of probability weighted amounts, especially when there are binary outcomes, likely would lead to recording revenue at an amount that is not a possible outcome under the contract. The approach adds unnecessary complexity to the assessment of transaction price for a result that would not accurately reflect the transaction prices and underlying economics of the transaction or provide decision useful information to a user of the financial statements. Furthermore, this methodology will be very difficult to implement, as there will be many complexities that companies will encounter when working to determine a harmonized methodology for assigning probabilities and documenting those probabilities for audit support, especially for organizations with various operating segments, such as ourselves. In our industry, we have become proficient in the use of estimation techniques, and using management’s best estimate allows us to apply that proficiency together with the knowledge and expertise gained by management through extensive prior experience.

Therefore, we support the use of management’s best estimate for the measurement of a variable transaction price. We believe that management’s best estimate is well understood in our industry and is the most useful measure as it allows for the exercise of management judgment based on experience to determine the transaction price. It also provides the most decision useful information for investors as it would reflect the most likely transaction price expected to be received rather than a range of possible, arbitrary outcomes. Therefore, we suggest that the Proposed Standard be modified to allow the use of estimates using either the probability weighted assessment model, or management’s best estimate based on management’s analysis of which is most appropriate in the circumstances.

If an entity were not able to support an estimate for variable consideration included within a contract, no revenue should be included in the transaction price for the variable element that is not estimable.

### *Allocating Changes In Transaction Price To All Performance Obligations May Distort Contract Performance*

We appreciate the Boards’ concern that changes in the transaction price be allocated to all performance obligations in the contract rather than to individual performance obligations. However, when it comes to a performance obligation with variable consideration, we would propose that the Boards clarify that if variable consideration relates to an individual performance obligation, an entity should allocate changes in the estimate of the variable performance obligation only to the related performance obligation. Allocating changes in variable consideration across the entire contract rather than to the performance obligation with the variable revenue component

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distorts the economic consequences of all of the performance obligations instead of faithfully presenting the economic consequences of the performance obligation with the variable transaction price.

For example, many of our contracts have award fees for which we estimate initial revenue. These estimates are adjusted periodically, and under the Exposure Draft, such revisions would be allocated across all performance obligations even where the award fee component is only earned on a single performance obligation. We believe that changes in variable consideration that solely result from the attributes of a single performance obligation should only be allocated to the performance obligation with the variable revenue component.

**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?**

We do not agree that a customer's credit risk should be reflected in the estimate of the transaction price but rather we believe it should be accounted for as an adjustment to contract earnings through recording bad debt expense as an element of cost of sales. We do not think that there are any weaknesses or inconsistencies with either the conceptual basis or application of the current model for accounting for contract collectability.

**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?**

Conceptually, we agree that an entity should reflect the time value of money where an explicit or implicit material financing component exists. However, the guidance as currently drafted is restrictive and implies that timing of payments is the only criterion for whether or not a financing component exists.

We request that the Boards develop this guidance to be more principles based, allowing an entity to take factors such as management's intent and historical practice into consideration. In the long-term contracting environment, we believe that customary contract terms and conditions have evolved to deal with the range of risks inherent in the contract. In many cases, contract payment terms are designed to protect the contract performance risks undertaken by the contractor and are not intended as a financing mechanism. In situations such as this, when a prepayment or advance deposit is provided for in a contract, we ask that the standard not require the application of the time value of money principle if such payment terms are normal and customary under the circumstances. Similarly if the terms differ substantially from the customary terms and conditions because the time value of money is a consideration, then we agree that the contract price should be adjusted. Without a change to this guidance, we would be required to apply time value of money to thousands of contracts, where there was no intent that a financing component was present.

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**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?**

Assuming that a distinct performance obligation is identified (see previous discussion regarding identification of distinct performance obligations at question 2), we generally support the allocation of the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price of the good or service underlying each of those performance obligations. Additionally we agree that as long as the method of estimating standalone selling price is consistent and maximizes the use of observable inputs, that no method of estimation should be precluded or prescribed.

### *Transaction Price Allocations Should Not Result In Onerous Performance Obligations At Contract Inception*

We believe that recording an onerous liability for a performance obligation at inception of an overall profitable contract does not provide decision useful information. We understand the Boards feel it is preferable to apply the onerous test at a performance obligation level to ensure the timely reporting of adverse changes in circumstances. However, if the separation of a profitable contract into its performance obligations at inception yields certain performance obligations that appear to be onerous, we believe that it may be appropriate to combine the contract performance obligations and recognize revenue at the contract level. A loss at inception for a performance obligation would seem to indicate that there are significant interdependencies between the performance obligations within the contract such that they should be combined for revenue recognition purposes.

We recommend that the onerous performance obligation guidance in paragraphs 54 through 56 be revised to require that the onerous test be performed at the contract level if performance obligations within an otherwise profitable contract appear to indicate an onerous condition at inception.

**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?**

See the combined response to Questions 8 and 9 below.

**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.**

## Replies to Questions for Respondents

### **Do you agree with the costs specified? If not, what costs would you include or exclude and why?**

The following response addresses questions 8 and 9:

#### *Cost Deferral Guidance Should Be Brought Forward Into The New Standard*

We appreciate that the Boards have included guidance in the Proposed Standard regarding contract costs that may be recognized in completing performance obligations. However, because the Proposed Standard will supersede existing U.S. GAAP that specifically supports deferral of certain costs related to work-in-process on long-term construction/production type contracts, that is not contained in other standards that will remain in effect after the adoption of the new standard, we believe it necessary to include such support in the new standard. While reference is made to a number of other standards in both U.S. GAAP and IFRS that will be unchanged upon adoption of the Proposed Standard, there are elements of these standards that are different, and it may not be appropriate for an entity applying U.S. GAAP to rely on IFRS guidance to support the deferral of certain costs and vice-versa.

For example, consider entities that currently use the “units-of-delivery” method under U.S. GAAP, which uses unit sales values and costs to record revenue and cost of sales. In this context, revenue may be determined based on contract-specific per unit pricing or an average price per unit based on overall contract value. Likewise, unit costs for the product/service may be based on actual unit cost, an average-unit-cost approach based on total costs at completion divided by the number of deliverables in the contract, or other reasonable methods. It is not unusual under a construction or defense industry contract currently applying ASC 605-35 for actual cost per unit to decline significantly over the life of the contract due to the custom-built nature of the units and relatively low number of units produced, thus making the average-unit-cost method more reflective of actual economics. In cases where actual costs per unit are utilized (rather than average cost per unit) and the contract is profitable, cost of sales is recorded at an amount equal to the sales value, and the excess of actual costs over recorded costs is deferred and spread over future units once break-even is reached. If the contract is in a loss position, the loss is recognized in the period in which it is identified. This is consistent with current practice, as described in Section 3.20 of the American Institute of Certified Public Accountants (“AICPA”) Federal Government Contractors Audit and Accounting Guide.

In the absence of guidance that supports the measurement of revenue and cost of sales in a manner similar to that used today under the “units-of-delivery” method of accounting, entities may infer a need to record losses on early production units and profits on later production units under contracts for which an overall profit margin was contemplated when negotiated with the customer. This outcome would have a significant effect on the way such contractors are recognizing revenue today, and the adoption of the new revenue recognition standard will adversely affect such contractors. Because such a pattern of recognizing contract revenues and earnings would not reflect the overall economics of the contract, it could drive the need to report non-GAAP measures to supplementally provide decision useful information to financial statement users. We believe this would not be an intended or helpful outcome of the standard setting process.

We believe the Boards should add guidance supporting the use of average-unit-cost or provide more specific language that would allow deferral of normal manufacturing costs expected to be recovered

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on the contract. For example, ASC 330, *Inventory*, supports several methods (e.g., LIFO, FIFO, average) for determining inventory cost and states in choosing a method, “the major objective...should be to choose the one which, under the circumstances, most clearly reflects periodic income.” This concept is consistent with current practice, as discussed above, on certain long-term construction/production type contracts that use net realizable value for determining the upper limit of costs to be deferred, which in many contracts is the actual contract value. We request similar guidance in the Proposed Standard, thereby allowing entities to account for revenue and related costs in a manner that best reflects the overall economics of their arrangements with customers.

Considering the above, we suggest that the Boards consider including language similar to the following in paragraph 58 either as a separate item, or as an inclusion to one of the existing items:

***“Costs allocable to undelivered units produced as part of a continuous or sequential production process to a customer’s specification accounted for using an average units-of-delivery model, to the extent such costs do not create an onerous performance obligation.”***

### *Abnormal Costs Should Be Better Defined*

We believe that the term “abnormal costs” as used in both paragraph 33(b) and paragraph 59(c) needs further definition. In the Construction and Aerospace and Defense industries, contractors are required to anticipate and make their best estimate of all of the costs required to complete a contract at the outset of the performance of the contract and to monitor such cost estimates over the contract performance period. It is not uncommon for cost estimates to vary over the performance period as actual costs become known, and for new, unexpected costs to develop that are specifically related to the performance of a given contract. In this context, it is very difficult to attempt to identify whether such changes in cost estimates result in “abnormal costs” as there is no clear distinction as to what constitutes “abnormal costs,” particularly if such costs are required and relate directly to the requirements of a specific contract. We acknowledge however, that costs that relate to excess/idle capacity or similar costs that, provide no utility to contract performance, or are material and infrequent/non-recurring costs such as those related to work stoppages, natural disasters, or other force majeure incidents not anticipated in the normal course of business are “abnormal” in nature and should be expensed as incurred.

If, however, “abnormal costs” are also intended to include costs due to the realization of risks that were possible at the inception of a contract (but not considered highly likely), such as rework, work-arounds, unplanned scrap, re-design costs and similar items, we are concerned because we currently include such costs in contract cost estimates and these impact the overall profitability of the contract. In our industry such costs are considered “normal” contract costs and are included in measuring our performance on the contract.

Furthermore, we are concerned that separate designation of costs such as these as “abnormal costs” could result in an opportunity to manipulate the reporting of contract margins and produce results that are not decision useful to investors. For example, under existing U.S. GAAP, if actual rework costs on a contract exceeded the initial estimated amount for a contract with an initial margin rate of 10%, these incremental costs would be included in the contract cost estimate and reduce the contract margin rate. However, if a contractor were permitted to treat these rework costs as “abnormal costs,” the Proposed Standard implies the contractor could expense the rework costs

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under a separate financial statement line item and still report a 10% gross margin on the overall contract.

In this manner, the financial statement line item “abnormal costs” appears similar to an “extraordinary item” that financial statement users could exclude in contemplating the contractor’s normal operating results, which would potentially cause significant confusion. This appears to skew reported results in a manner that does not reflect the economic substance of contracts with customers and renders any assessment of future performance less predictive. In addition, this approach presents application challenges, as increases in cost estimates are often identified after the initially incurred effort (e.g., initial performance of effort in one quarter is later determined in another quarter to be deficient; and many of these increases could relate to past or future effort on the contract). The mere fact that such changes in contract cost estimates could be allowed to be evaluated to determine whether such costs are “abnormal” and could thus be excluded from contract margin performance seems to open the door for a wide variety of practices which would result in variability in financial reporting and reduce the effectiveness of the comparability of information between similar companies in the Construction and Aerospace and Defense industries.

### *Allowable Bid And Proposal Costs Should Be Capitalized*

In the Aerospace and Defense industry, bid and proposal costs are recoverable under the FAR and are capitalizable for U.S. GAAP purposes per ASC 605-35-25-41. Under the proposed guidance, these costs would be capitalizable per 58(d) “costs that are explicitly chargeable to the customer under the contract,” but not per 59(a) “costs of obtaining a contract (for example, the costs of selling, marketing, advertising, bid and proposal, and negotiations).” To resolve this likely inadvertent discrepancy, we suggest that you modify 59(a) to state “costs of obtaining a contract (for example, the costs of selling, marketing, advertising, bid and proposal, and negotiations) unless criterion 58(d) has been satisfied.”

**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?**

See the combined response to Questions 10, 11, and 12 below.

**Question 11: The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.**

**Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?**

See the combined response to Questions 10, 11, and 12 below.

**Question 12: Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why?**

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The following response addresses questions 10, 11 and 12:

As the proposed model will apply across all industries, we do not believe prescriptive disclosures are beneficial given the substantial differences across business models. We suggest requiring disclosures at a principles based level, as opposed to prescriptive disclosures that may not be meaningful to financial statement users. A principles based approach would allow different industries to provide relevant information to their respective financial statement user groups.

We believe the disclosure principle in the Proposed Standard needs to weigh three key elements: 1) the benefits investors will receive versus the cost to provide the disclosures; 2) the level of disaggregation of quantitative disclosure information and principles to determine that level; and 3) when non-financial or forecast data should be included in the required disclosures and the related impact on the independent audit process and the safe harbor protections afforded companies by the U.S. Securities and Exchange Commission (“SEC”) under Rule 175.

In our industry, we do not provide products or services that are mass produced in homogeneous categories or groupings, rather we perform on thousands of unique contract activities to meet the specific needs of our customers, and it is normal to revise estimates for these thousands of contracts on a quarterly basis. Today, we generally use the contract as the profit center for evaluating the operating performance results for our business. In this context, the compilation of quantitative information across a broad range of contracts or programs is of little value in providing an understanding of how our business is operating and will be overly burdensome to compile. What is more insightful is how we are doing on our major programs, and gaining an understanding of the contract mix (flexibly-priced vs. fixed price) within our contract portfolio. It is for these reasons that we believe that quantitative tabulations of activity within our contract balance sheet accounts will not provide decision useful information to our investors. We believe that quantitative disclosures should be used to supplement the qualitative disclosures about an entity’s contracting activities, such as disclosure of the percentage of contracts that are either flexibly-priced or fixed-price, or the nature and amounts of unbilled receivables that are not expected to be billed in the ensuing billing period.

Similarly, disclosure of unusual or infrequently occurring quantitative amounts together with a narrative description of the reasons for such items would also represent decision useful information. We believe that such dynamic analytical disclosures are far more useful to investors than prescriptive tabular disclosures that simply reconcile account activity.

### *Disclosure Of Forecasted Financial Information Would Be Inappropriate*

We believe the requirement to disclose forecasted financial information (such as the break-down of backlog by expected year of performance) significantly expands the scope of the financial statements and is inappropriate in accounting guidance that is otherwise devoted to the reporting of historical financial results. This disclosure would result in the disclosure of material, non-public information based on projections of forward-looking data being included in the audited footnotes. This level of information goes beyond what is currently provided to shareholders and analysts in the typical earnings guidance and would disclose sensitive information to competitors in our industry.

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Additionally, auditors would be required to audit long-range planning information that is subject to many changes and variability, and subjective estimation. Lastly, inclusion in the footnotes would forego legal protections afforded by the SEC under Rule 175. If the Boards' view this information as necessary, we would suggest requiring it be disclosed in a qualitative discussion.

### *Costs Of Providing Proposed Disclosures Would Outweigh The Benefits Derived By Investors*

Finally, we believe the additional cost of creating the necessary information technology infrastructure to accommodate these proposed disclosure requirements would outweigh the benefits. Much of the information requested is not available today in our cost accounting systems because it does not provide decision useful information to management. We question the rationale for requiring companies to modify their accounting systems to generate information solely to support financial statement footnote disclosures when such information is not useful for any other purpose by management.

**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.**

We disagree with retrospective application of the Proposed Standard. Our company has thousands of contracts in process at any given time, the majority of which are long-term contracts spanning several years in duration. For us, as well as other entities with complex multiple-element arrangements and construction or other long-term contracts, retrospective application will be cost prohibitive to the preparer.

We noted that paragraph 232 of the "Transition" section of the Basis for Conclusions acknowledges that retrospective application of this Proposed Standard would be burdensome, but that some of these concerns would be mitigated by the following:

- (a) "Topic 250 and IAS 8 limiting the retrospective application of an accounting policy if it is impracticable; and
- (b) The Boards contemplating a long lead time between issuing a standard on revenue from contracts with customers and its effective date, which would reduce the extent of hindsight needed in applying this standard"

### *Retrospective Application Is Impracticable*

We believe that many entities, including Northrop Grumman, would meet the threshold of impracticability from mitigating factor (a), as described below. We are concerned however with the substance of this mitigating factor, based on the fact that historically regulators have held the threshold of impracticability so high that it has offered no relief to public filers. Our review of impracticability was based on the following three factors from ASC 250-10-45-9 (our comments are in italics):

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- After making every reasonable effort to do so, the entity is unable to apply the requirement - *Revenue recognition for Northrop Grumman, like companies in most other industries, is based on thousands of contracts (or transactions), and to restate recognition from contract inception would be an extremely complex, very time consuming, and manual exercise for contract management and finance personnel, given we use a variety of systems in conjunction with manual entries to record revenue.*
- Retrospective application requires assumptions about management's intent in a prior period that cannot be independently substantiated - *Assumptions and estimates are often updated throughout the course of a contract, and are evaluated along with other contemporaneous information relating to the contract's performance. Thus, independent substantiation will not be consistently available and exact recasts for many contracts will not be possible. Furthermore, taking the time to determine where and if accurate documentation of management intent exists would be overly time consuming, and potentially end in little useful result.*
- Retrospective application requires significant estimates of amounts, and it is impossible to distinguish objectively information about those estimates that both:
  - Provides evidence of circumstances that existed on the date(s) at which those amounts would be recognized, measured, or disclosed under retrospective application
  - Would have been available when the financial statements for that prior period were issued

*We believe that in trying to apply the standard retrospectively, we would be faced with these practical limitations such that retrospective adoption would be virtually impossible.*

Mitigating factor (b), although helpful for planning purposes, does not mitigate the cost and effort involved in compiling the comparable information and does not mitigate the impact for contracts that last several years in duration. Northrop Grumman has many existing contracts that will still be in progress at the time of implementation, and the burden of retrospective application for these contracts will be impractical for the reasons stated. Furthermore, the costs to track and report contracts under dual principles for extended periods of time would be cost prohibitive, time consuming, and provide limited benefit.

### *Prospective Application Is The Most Practicable Approach*

Given the above, we suggest that the proposed guidance be applied prospectively for contracts with customers entered into after the effective date of the standard, with the option of retrospective adoption. Paragraph 234 of the Basis for Conclusions indicates that the Boards did not elect a prospective transition because the recognition and measurement of revenue would not be comparable between the current and comparative periods. However, the Boards have also stated that they did not intend for the Proposed Standard to have a material impact on how companies recognize revenue, which would imply that a prospective transition would not materially impact a company's comparative disclosures.

To address the Boards' concern regarding the preservation of trend information about revenue, we suggest that entities be required to disclose information that enables users of the financial statements to understand the effect of the change in accounting principle in the spirit of ASC 250. Some disclosures that may be useful include:

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- The method of applying the change, and any material impact on the current period of applying the change to new contracts;
- A qualitative and/or quantitative discussion of the entity's major products and services for which revenue recognition under the proposed guidance will be materially different;
- The portion of the entity's revenues and/or earnings in the period that have transitioned to be accounted for under the proposed guidance;
- An estimate of the run-out of the company's backlog accounted for under the former standards;
- Comparative information for either the period of change or the period immediately preceding the change.

We also request that the Boards conduct an intensive cost/benefit analysis and significant field trials in order to understand the complexity and lack of existing system capabilities before concluding on retrospective application.

### **Question 14: The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance.**

#### **Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?**

In order to make the proposals operational we believe that the Boards will need to include additional examples with more complex fact patterns in the implementation guidance. Currently, the implementation guidance only covers a small sample of transactions that are in most cases too simplistic to be useful. If sufficient guidance is not provided, there is risk of the following:

- Diversity in practice across companies and industries
- Default to prior accounting practices/policies
- Reliance on accounting firms for definition of the principles from the standard

We suggest that you include separate examples for products and services, as they have unique considerations. Some example fact patterns for which we think implementation examples would be useful are:

- The application of the segmentation and performance obligation separation guidance for contracts with complex deliverables that have numerous discrete tasks, phases, and deliverables. Examples of discrete tasks, phases, and deliverables include, design/build, implementation, training, and operations and maintenance.
- More examples of when goods and services have a distinct function or profit margin, spanning across various industries. We think that this is important because each industry has its unique challenges.
- When the input and output methods of measuring continuous transfer would be appropriate, using the factors proposed in our question 3 response.
- Circumstances in the long-term contracting environment where the Boards would expect a material financing component to exist.
- Illustration of what costs should be included when recognizing revenue for contracts with complex deliverables using an input method.

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**Question 15: The Boards propose that an entity should distinguish between the following types of product warranties:**

- (a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.**
- (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.**

**Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?**

We agree, in theory, with the proposed distinction between the types of warranties. However, we are concerned that absent clearer guidance on what constitutes a latent defect and what constitutes a post delivery defect, it will be very difficult for companies to consistently apply the standard.

We believe our current model, which treats standard warranties as an element of contract costs, is a more useful and accurate representation of the economic substance of warranty obligations. Generally, warranties entitle customers to repair or replacement of defective deliverables and do not entitle them to refunds; as such, we believe the provision of a standard warranty is a cost of contract performance as opposed to a separate performance obligation. Treating a standard warranty as a distinct performance obligation infers that warranty represents a separate revenue-generating activity, which is atypical in our industry.

We agree that separately priced extended warranties, which the customer may purchase at their own discretion, should be accounted for as a separate performance obligation.

**Question 16: The Boards propose the following if a license is not considered to be a sale of intellectual property:**

- (a) if an entity grants a customer an exclusive license to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the license; and**
- (b) if an entity grants a customer a nonexclusive license to use its intellectual property, it has a performance obligation to transfer the license and it satisfies that obligation when the customer is able to use and benefit from the license.**

**Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the patterns of revenue recognition proposed by the Boards? Why or why not?**

We disagree that the pattern of revenue recognition should depend on whether the license is exclusive or non-exclusive. We believe exclusivity affects the perceived value of a product or service and does not have bearing on when revenue should be recognized. As such, we do not believe that it makes sense to require different revenue recognition methodologies for exclusive and non-exclusive licenses. Instead, we believe that licenses should be accounted for in line with the

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proposed revenue recognition model, recognizing revenue upon fulfillment of the performance obligation. We suggest that the Boards provide guidance regarding when an entity fulfills the performance obligation for a license, and that they specify only one pattern of revenue recognition for both types of licenses.

**Question 17: The Boards propose that in accounting for the gain or loss on the sale of some nonfinancial assets (for example, intangible assets and property, plant, and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model.**

**Do you agree? If not, why?**

We do not believe that the accounting for these transactions should fall within the scope of this standard. These represent non-standard transactions unrelated to the company's ongoing central operations and revenue generating activities for which there already exists clear accounting guidance.

**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?**

No, we do not feel that any of the guidance should be different for nonpublic entities. Revenue recognition is significant to all entities, public or nonpublic. If the Boards determine that the Proposed Standard is an improved revenue recognition model, then all aspects of it should be required for all entities. One of the primary reasons for the Proposed Standard was to provide a single comprehensive model to use in reporting information about the amount and timing of revenue resulting from contracts to provide goods or services to customers. Allowing nonpublic entities to follow different requirements for some areas of the proposed revenue model will reduce comparability.

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