



October 22, 2010

Technical Director
File Reference No. 1820-100
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5446

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

Dear Director:

On behalf of the 9,000 members of the Virginia Society of CPAs (VSCPA), we have reviewed and discussed the above-referenced Proposed Accounting Standards Update. While the VSCPA is supportive of the Financial Accounting Standards Board's (FASB) goal of aligning U.S. Generally Accepted Accounting Principles (GAAP) with International Financial Reporting Standards (IFRS), the proposed standard will likely carry significant costs for certain industries, while the benefits of its implementation are unclear — or at least limited. In particular, the additional costs that may be necessary for the construction industry could be substantial. Adoption of the new standard may require obtaining new expertise and making major changes to accounting software. Additionally, significantly more time will likely be required to develop new procedures, draft new disclosures and gather additional data. These additional costs come as the U.S. economy continues to recover from a prolonged recession that has been particularly challenging to industries involved in real estate, including many construction firms.

We expect the new standard to have little effect on most companies and, as such, will not change current standards of revenue recognition for those companies. Hence, our comments will focus on those areas in which we disagree with the proposed principles.

It is not clear how the change from a model where revenue is recognized as a contractor performs (percentage-of-completion method) to a model where revenue is recognized based on transfer of control will improve financial reporting. In fact, it is our opinion that this change will reduce the effectiveness of financial reporting. For these reasons, we urge the Board to amend the proposed standard to allow all companies the option of continuing to use the percentage-of-completion method and to reconsider the focus on performance obligations and control over assets.

The VSCPA has the following specific comments related to select questions as outlined in the "Questions for Respondents" section of the proposal:

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?

Response: We do not agree with the larger principle of establishing multiple performance obligations for purposes of recognizing revenue. Specifically, we have concerns with the accounting theory involved. Companies with contracts that involve single performance obligations

will likely not recognize any revenue until contract completion under the proposed regulation. This will result in a completed-contract method of recognition that violates the matching principle. An additional negative effect of this example is that these companies will not recognize any revenue or profit until contract conclusion. For contracts that continue over the end of a reporting period, this will create a distortion in the financial statements by showing no revenue for a contract in the current period, even if it is nearly complete and there is little risk of non-completion. This could also result in increased volatility for the gross profit of some companies.

For many companies, the focus on performance obligations and control over an asset will result in elimination of the percentage-of-completion method of revenue recognition. This change will particularly apply to construction companies. Users of financial statements of these companies, such as banks and surety firms, have spent decades developing evaluation procedures centered around the percentage-of-completion method. They are likely to insist on its continued use as a proven and reliable method. In fact, the VSCPA notes that at least one prominent surety company has already issued a comment letter in response to this proposed standard expressing these concerns. Lack of adoption by banks and surety companies could place construction companies in the position of being required to produce two sets of financial statements at significant additional cost.

A similar problem will exist with tax accounting. To date, the IRS has not indicated if it will recognize the new method of accounting. Thus, the divide between book and tax income could become wider.

Establishing multiple performance obligations will allow companies with similar economic circumstances to identify different performance obligations and therefore recognize revenue and different times. This will negatively affect comparability among financial statements of various companies.

In addition to the accounting theory, we also have concerns regarding the increased costs of implementing this standard. The cost of tracking these performance obligations may be onerous. Companies will be required to update their accounting software. Smaller companies using simple software packages will have to purchase new versions that comply with the new requirements after vendors develop and release them. Firms with more sophisticated software packages will be required to contract with service providers to implement upgrades to their software. Publicly traded companies that are also required to obtain opinions on their internal controls over financial reporting will have to include IT and accounting consultants in this process to ensure that their general and application controls are designed adequately to allow them to receive unqualified opinions over these controls.

Costs will also be required to update policies and procedures and to redesign methods of estimating and structuring contracts. Additional training costs will be required to enable accounting personnel to comply with the new method. Large companies will likely be forced to engage accounting, IT, and legal professionals to ensure all changes are made correctly.

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?

Response: We do not agree with this principle. Current standards call for recognizing revenue according to contract terms and establishing an allowance for doubtful accounts with corresponding entries to bad-debt expense. This creates consistency among all types of revenue recognition. It also provides key financial ratios that are commonly relied upon by users of financial statements to evaluate the financial condition of a company. By including bad-debt expense separately, users of financial information are better able to assess how well a company is able to manage its credit risk. The proposed standard seems to eliminate this treatment and

instead reduce revenue by amounts that are estimated to be uncollectable. In addition, the proposed probability-weighted method of estimating collectability is both complicated and subject to manipulation.

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?

Response: We do not agree with this principle. The determination of “materiality” is subjective and its use, as proposed in paragraphs 44 and 45, is likely to result in inconsistent application of the proposed Statement, reducing inter-firm comparability of published financial statements, as well as disagreements between clients and auditors as to the materiality threshold.

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?

Response: The proposed disclosure requirements will not meet that objective. Significant areas of the proposed standard require the use of estimates, which in turn require judgment, and are therefore subject to differing results even for identical contracts. Examples of this include determining such things as when contracts are distinct, what goods or services represent performance obligations, and when these should be aggregated or disaggregated. This will negatively affect comparability among companies as different companies and their auditors make different judgments and estimates.

While the changes requiring additional use of estimates are accompanied by additional disclosure requirements, this only partially mitigates the negative effects. It provides users of the financial statements information in the notes to assist them in interpreting the amounts reported as revenue. However, in our view, this results in pushing information back to the notes, which means that the actual financial statements will have reduced comparability even among similar companies.

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.

Response: We agree that retrospective application of new accounting standards is generally preferred to maintain historical comparability. We also recognize, however, that retrospective treatment is not always applied to new pronouncements, because in some cases it may be difficult or even impossible to apply the standards retrospectively. We think that this proposed standard represents one of those instances. In particular, with the use of performance obligations, it may be difficult and in some cases impossible for companies to identify performance obligations if they were not identified explicitly in the contract. This is another example of how some firms will be required to re-state their financial statements and obtain audit opinions on these re-stated financials, incurring significant internal cost and effort.

In summary, while we support the Boards’ goal of creating consistency among international and U.S. accounting standards, the proposed standard on revenue recognition would fail to improve the quality of financial reporting. Rather, due to the complexity of the proposed standard, the expanded use of estimates requiring judgment, and the elimination of the percentage-of-completion method, the quality and usefulness of financial reporting will likely be decreased. We recommend that the Boards revisit the principles addressed above. If the Boards decide to implement the proposed standard, we urge them to

adopt a delayed effective date to allow companies sufficient time to make the changes necessary for compliance.

The VSCPA appreciates the opportunity to respond to this Proposed Accounting Standards Update. Please direct any questions or concerns to VSCPA Government Affairs Director Emily Walker at ewalker@vscpa.com or (804) 612-9428.

Sincerely,

A handwritten signature in black ink, appearing to read "Bradford R. Jones". The signature is fluid and cursive, with a long horizontal stroke at the end.

Bradford R. Jones, CPA
Chair, Virginia Society of CPAs