



financial executives
international

COMMITTEE ON PRIVATE COMPANY STANDARDS

October 22, 2010

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116
Sent by email to director@fasb.org

File Reference No. 1820-100

Dear Technical Director:

The Committee on Private Company Standards (CPC-S) of Financial Executives International (FEI) wishes to express its views on the Financial Accounting Standards Board's (FASB's) Exposure Draft of a Proposed Accounting Standards Update, *Revenue Recognition (Topic 605): Revenue from Contracts with Customers*.

FEI is the leading advocate for the views of corporate financial management in the United States. It is a professional association of more than 15,000 CFOs, treasurers, controllers and other senior financial managers. CPC-S is a technical committee of FEI which formulates private company positions for FEI in line with the views of the membership. This letter represents the views of CPC-S and not necessarily the views of FEI.

General Comments

We have followed closely the FASB's evolution of thought as it seeks to develop a single, comprehensive standard for revenue recognition. We have been concerned that earlier presentations and drafts on this proposed standard have excluded a fundamental definition of revenue, but have instead focused on recognition and measurement of something that does not match the common understanding of the term revenue as used in commerce. We believe that revenue is defined as *an entity's flow of its product (i.e., its goods and services) to a customer*, and this definition is based on the assumption that the primary purpose of a for-profit entity is to structure all of its operational activities and deployment of its capital around efforts to sell its product at a profit.

We note the FASB has finally at least associated a definition of revenue by inserting this language in paragraph 2:

The core principle would require an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it receives, or expects to receive, in exchange for those goods or services.

However, in our view, not only this core principle is not borne out by the contents of the proposed standard, but the contents of the ED actually contradict this core principle. (We note that the FASB does not ask in the Questions section if constituents agree with the language of the core principle, and that reference to the principle is conspicuously by-passed in the premise of Question 1). The ED requires focus of recognition and measurement to be placed on the initially mutually offsetting contract benefits and contract obligations and not on the transfer. Only when there is a transfer of control is revenue recognized; however, the revenue amount that appears in the income statement is, de facto, a by-product of the re-measuring of contract obligations and is not the transfer process as defined in the core principle, nor is it the common understanding of the term revenue.

It is our view that the core principle as written obfuscates the reality of the ED's proposed standard which is in fact the introduction into financial reports of the creation of a type of new asset (a sales contract) and new type of liability (a sales performance obligation) that are mutually netted. Changes in the recognized values of these assets and liabilities over accounting periods are run through the income statement and these periodic valuation changes are given the name "revenue". Unfortunately, the stated core principle throws off the reader from the reality of this asset/liability approach by its reference to the traditional and commonly understood definition. We believe readers are better served by the FASB incorporating a clear explanation of its continuing evolutionary policy of changing the purpose of the income statement away from measurement of operational performance based on an entity's selling of its product and into a display of a reporting period's changes by nature of the balance sheet present values of probability-adjusted future cash flows.

We understand that certain users of public entity financial reports, specifically public entity equity analysts, prefer to focus on the recognition of the present values of probability-adjusted future cash flows and define the income statement as the recognition of the change in these values over time. This view is consistent with the view expressed by the CFA in its 2007 document, *A Comprehensive Business Reporting Model: Financial Reporting for Investors*, calling for discontinuing the actual display of net income from revenues and expenses within the income statement.

However, we find that the general focus of private company financial statement users, including our own focus as users, is on the reliance of the income statement to provide the results of the company's past operational performance of the reporting periods presented and the cash generated or expended by the operational performance through a process of realization. The secondary focus of private company financial statement users is on the nature of the operational resources, operational obligations, and the owners' investments of the private company measured primarily at their input values recognized at the date of the exchange, less the using up of the input values in the periods benefited.

Accordingly, we believe that there is a fundamental difference between users of private company financial statements and the use of public entity financial reports by public entity equity analysts.

On behalf of private company financial statement users, including our own use for investment and credit decisions, we have extensively defined the nature of revenues, recognition and measurement in our May 2010 working draft white paper, *A Model Conceptual Framework for Private Company Accounting Standards*. We will not re-produce those views here other than to provide this definition:

A private company's revenues are the measurable flows of its product to customers, resulting only from exchange transactions that occurred during a past reporting period, and more likely than not favorably increased operational performance in that past reporting period.

We further define the revenue measurement attribute to be the exit price of the entity's product, and while a revenue transaction always results in a (promised) net asset inflow, we believe that the measurement attribute of the net asset inflow is the separate input cost of that new asset (which initially is almost always equal to the exit price of the revenue, but can be independently re-measured over time based on the application of the principle of realization). We believe that the end of an entity's operational earnings cycle is realization -- realization is the process of converting noncash resources and rights into money and the settlement of obligations by payment of money or other assets that could be converted into money -- and that the nature, timing, pattern and likelihood of realization is a better indicator than attempts to detect "benefits received" by a customer as the basis for satisfying a performance obligation. We also believe that the principle of realization is a more useful approach in determining revenue recognition for components of multi-element contracts than price allocation based on externally observed fair values.

Accordingly, we do not believe that private company users desire revenue recognition to be redefined as the change in periodic valuation of contract assets and obligations. We also do not believe that private company financial statement users desire the measurement, recognition and disclosure of mutually unfulfilled contracts, even if disclosed only in the notes. We also do not believe that the exit price of a good or service should be altered by the credit worthiness of an entity's customer (we define credit worthiness as the ability of the customer to provide to the entity the realization of the input price of the promised consideration), but instead credit worthiness should be applied to the measurement and subsequent periods' re-measurement of the realization of the input price. We believe that separate disclosure of the effects of credit worthiness on realization, such as an allowance for doubtful accounts, is important information for decision-making by private company financial statement users and should not be "hidden" from these users by the ED's proposed netting against revenue. We believe that private company users desire that any associated obligations of a performance contract would only be recognized, and recognized separately from revenue, if in fact the associated obligation meets the definition of a traditional liability. We believe that private company users find the disclosure of these liabilities, such as warranties, to be useful for decision-making and would not want these hidden in revenue.

We also believe that for private companies whose revenues consist of providing goods and services under long-term contracts, and particularly construction contracts and continuous service contracts, that it is extremely important to their financial statement users to be able to discern the achievement of projected profit margins from their contracting operations. Accordingly, custom and tradition in reporting periodic revenue over the life of a long-term contract are more important to private company users than achieving a single comprehensive revenue standard based on a unified theory. In our collective experiences, private company financial statement users prefer to maintain the traditional matching principle -- i.e., the matching on the face of the income statement of those costs associated with revenues in a consistently applied process instead of the ED's proposed standard that would (a) interrupt the concept of earnings

recognition over the life of a long-term contract with the ED's definition of control, and (b) interrupt the concept of matching with the ED's independent prescription for recognizing costs as assets or expenses.

An Example

The contrast between our view of the traditional, commercial definition of revenue as the primary component of determining operational performance of an entity and the ED's method of recognizing revenue by satisfying performance obligations, as expressed by the ED's paragraphs 25 and 26, results in different revenue recognition in many of the ED's examples. Space does not permit an item-by-item analysis; however, the following example makes the differing views clear.

First, to re-iterate, our view is that revenue is a flow of an entity's product to a customer; revenue is measured at an exit price; a new asset (promised compensation) is received at an input cost. The final verification that revenue should have been recognized in a reporting period is the subsequent realization of the separate, promised consideration and the absence of a traditional liability requiring a future earnings operational process. This is based on our view that realization is the end goal of the earnings process, which is the primary focus of private company financial statement users. The contrasting view of the ED is that a performance obligation is created, and the final verification of the satisfying of that obligation and recognizing revenue in a reporting period is not realization but instead is the detection of a receipt of a benefit by a customer. According to the ED, if no receipt of benefit is detected, then no performance obligation is satisfied and no revenue is recognized. This appears to be the case even if realization has occurred.

So, in the ED's Example 7, for both the health club and payroll processing scenarios, the non-refundable upfront fee is not recognized as revenue, because the authors of the example cannot detect a benefit received by the customer, even though (a) realization has occurred, and (b) the reporting entity has no further obligation to the customer in exchange for the non-refundable fee. The ED requires the non-refundable fee to be recognized over the life of the services provided by the separate, but detectable, benefit period of the customer for the services it is receiving. However, what happens to the non-refundable fee if the customer cancels the contract? The answer is that it is recognized as revenue, or at least as some other sort of income. But, on what basis? The cancellation of a contract by the customer is neither a transfer of a benefit, nor a fulfillment of a performance obligation of the non-refundable fee. In this circumstance the ED's theory is broken.

Applying our view of revenue, the non-refundable fee is recognized as revenue. A flow of the entity's product has occurred at an exit price. The contract is a normal product of the entity, and it clearly has value to the entity since it does not give away its contracts. In the exchange (legally an exchange transaction has occurred), the entity has received a new asset in the form of promised consideration (which is simultaneously realized by the receipt of money). There is no obligation of the entity (since by definition the fee is non-refundable). The future operational activities of the entity to earn the fees for services provided are separate. Unlike the ED's model, our revenue model properly represents that the operational performance of the entity in regards to the non-refundable fee has in no way been altered, for the better or worse, by the customer's subsequent cancellation. We believe that financial reporting should make a faithful representation of this factual economic event.

Costs versus Benefits

While we appreciate that one of the goals of a single, comprehensive revenue standard would be to create a lower cost, compared to current practice, of applying the standard in financial statements; we believe that the application of the ED's proposed standard has the opposite effect. Implementing and applying the ED's proposed standard will impose huge costs on private companies, with no benefit to private company financial statement users. Many private companies who do not need to track contracts in their information systems will now be forced to do so. Other private companies that, due to the nature of their business, currently have fairly sophisticated and expensive systems for tracking long-term contracts, recognizing revenue under percentage of completion methods, and matching costs to the activity tracked by these systems, will incur massive costs of re-engineering or replacing software. The ability to apply retrospectively the ED is beyond the capabilities of most of these software systems. The cost of independently valuing distinct components or segments of contracts will require hiring outside valuation experts. Audit costs will increase as audit firms will develop and apply lengthy procedures to test the recognition and measurement of revenue. Income tax accounting costs will rise as well as the preparation and audit costs of more complex deferred tax provisions

However, perhaps the most telling cost versus benefit mismatch is that there will be a high cost of having a professional person or firm, possessing an understanding of both GAAP and contract accounting; reconcile the GAAP statements *back* to the models used by sureties and asset-based contract lenders. These users will continue to use their own models to monitor operational performance of their clients, and just as they do now, will want audited GAAP financial statements to provide *comfort* to their models -- which, unlike GAAP statements, contain the data that they actually use for decision-making purposes. However, since sureties and lenders do not actually lend against GAAP statements, there will be no reduction in the cost of capital that offsets the significant cost increase for preparing, auditing and (now) reconciling audited GAAP statements. Furthermore, we foresee the cost of capital actually increasing as sureties reduce bond credit due to the inconsistency of reporting revenues and unmatched relationships of costs to revenues in period-to-period financial statements. We foresee some private lenders and sureties dropping requirements for audited GAAP financial statements (we have anecdotal evidence that this is occurring now) for private companies with long-term contracts and replacing with demand for audits of individual contracts. We do not believe the ED should be applied to these private company constituents; none are benefitted.

We conclude this section by commenting on the view expressed by some standard setters that for some less complex private companies whose operations consist only of shipping and invoicing goods or providing and billing for basic services, the ED's proposed asset/liability-based standard would not result in any significant change in revenue recognition. We are compelled to provide two responses: First, if this is so, then why include these private companies in the scope of this standard? There is no benefit to anyone associated with these companies in making a change. Second, we interpret this as the standard setter's acknowledgement that the focus of the ED is on a specific category of public company financial statement users and not on fulfilling the stated FASB mission of issuing "one size fits all standards" for "general purpose" external financial statements. Why drag the private companies along?

We have provided below specific comments to the questions contained in the ED.

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?

Q1: As stated in our General Comments section, we do not believe that the starting point for recognizing revenue is to first recognize and measure contracts. Nevertheless, we have serious concerns with the requirement of paragraph 15 to segment a single contract for those private companies that have a small number of large dollar contracts. We believe that these private company financial statements users are better able to associate operational performance with the legal structure of an intact contract. Paragraph 15 requires a private company to segment a large contract if another entity regularly sells some of the individual goods or services contained within the private company's single, large contract. We believe that the resulting assignment of revenue in such a segmentation could obscure and even distort the reported profitability of a contract that extends over several reporting periods. As a result, we believe that reported operational performance in the income statement will be disconnected from the margins that were estimated at the incurrence of the contract and regularly reviewed by private company investors and lenders independently of the financial statements, and therefore will hinder or prevent these users from holding management accountable for achieving predicted margins of these large contracts. We also believe that the segmentation of large contracts will ultimately result in public company equity analysts, who desire comparability of public companies within industries, to request the FASB or EITF to create specific, granular rules for segmenting and will therefore create additional, unneeded burdens and complexity on private companies and their financial statement users.

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?

Q2: We do not agree with the definition of a distinct good or service as presented in paragraph 23. We do not believe that the definition of an individual private company's goods and services should be based on what other entities may sell or on the similarity to products or services sold by other entities. We believe that this definition will lead to demands for uniformity from public company equity analysts seeking comparability of public companies. We believe distinctiveness is more useful to private company financial statement users when determined solely by the operating activities of the individual private company and how a product or service contributes to that private company's operational performance.

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

Q3: We do not agree with Paragraph 25. First, we do not believe that the recognition of revenue should be based on a preceding recognition and measurement of an obligation that has not traditionally been recognized in financial reports (either on the face of the statements or in the notes). Instead we believe revenue is the actual transfer of goods or services to a customer and is measured at its exit price, and is not a by-product of the periodic re-measuring of performance obligations. Second, for some long-term contracts and some continuous service arrangements, the revenue recognition proscribed in Paragraph 25 results in a disconnect, between matching expenses to revenues under the matching principle in reporting periodic operational performance. Costs associated with these long-term contracts and continuous service arrangements are addressed independently in the ED in paragraphs 57-60. The recognition of these costs is governed by the asset definition contained in these paragraphs without consideration of the matching principle. Because private company financial statement users focus first on operational performance instead of changes in balance sheet valuations, the matching principle remains a desired characteristic of private company financial statements. However, the ED requires that certain costs be expensed as incurred while revenue associated with these costs is recognized separately under Paragraph 25. As a result, reported gross margins percentages from period to period may be viewed as distorted by private company users, and therefore (a) have less predictive value to them of the private company's future operational performance, (b) obscure the ability of a lender to determine if reported operating income is actually providing the earnings coverage stated in debt coverage ratios that lending covenants require to be consistently met, and (c) reduce the users' ability to hold management accountable for past performance. For long-term construction contracts, we believe that the current standards requiring the recognized percentage of total revenue to equal the recognized percentage of total cost of revenue should be maintained. This is how both lenders' and sureties' models are set up.

We partially agree with the definition of control in paragraph 26; however, we believe that the paragraph should first define revenue as a flow of an entity's product to a customer as we have in our General Comments section and that the definition of control given in paragraph 26 is not the best available proof of an actual product flow. The ED's definition of control forces a reporting entity to attempt to detect a benefit obtained by the entity's customer, instead of recognizing the benefit obtained by the reporting entity's operations and subsequently verified by realization.

While the first sentence of paragraph 27 may be a statement of fact, we believe that the remainder of paragraph 27 is an over-engineering of the definition of control and should be removed. We are concerned that these sentences in paragraph 27 put an onus on the entity to obtain customer verification that the product or service used by the customer enhances the customer's cash flow. The fact that a flow (as defined in the above sentences) has occurred from the entity to a customer is sufficient. We do not believe that the entity should be put in a position of determining what a customer will do (as long, of course, as it is not illegal) with the product or service.

We believe that paragraph 29 is unclear as to its intent. Under what circumstances, does a simultaneously created re-purchase agreement negate recognition of revenue? Consider these two examples. First, how is an entity's 2010 calendar-year income statement affected by a transfer of control of a product to a customer on December 31, 2010, accompanied by a right to repurchase exercisable on January 1, 2011? Second, how is an entity's 2010 calendar-year income statement affected by a transfer of control of a product to a customer on December 31, 2010, accompanied by a general repurchase agreement exercisable beginning one-year after December 31, 2010? Because the proposed standard is unclear, we believe that there will be substantial follow-up requests for the FASB staff or EITF to issue a myriad of specific rules. Paragraph 29 also appears to fit better as one of the subsets identified in Paragraph 30. We agree with section (a) through (c) of Paragraph 30. However, we disagree with (d) in its application to long-term construction contracts for the reasons stated above.

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?

Q4: While we do not believe that the starting point for recognizing revenue is to first recognize and measure contracts, we agree that revenue, as defined by us in our General Comments section, should be recognized only if the transaction price can be, at a minimum, reasonably estimated and we agree that the proposed criteria in Paragraph 38 can be useful in making this determination. However, we would add to paragraph 38 that "experience" can be demonstrated more preferably by referring to exit prices of past actual sales transactions.

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?

Q5: We disagree with both clauses in the question. We believe that revenue is recognized when the product or service flows to the customer (modified only by the probable threshold – i.e., at a minimum it is probable that there has been a flow of a product or service to a customer). We believe that there is a presumption that an entity will not *give away* a product or service to a customer who is known to be credit impaired; the entity either sells the product or service at a mutually agreed upon exit price or it does not sell it at all. We believe that this revenue should be measured at its exit price. The credit status of the customer does not modify the measurement of the established exit price. Instead, we believe that private company financial statement users prefer that the credit status of a customer should be considered in separately and subsequently measuring the resulting input price of the receivables from the customer.

The basis of this separate and subsequent measurement is the principle of realization -- i.e., the present value of money or net assets convertible to into money to be received from the customer.

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?

Q6: We agree with this exception: We believe that promised consideration expected to be realized under the principle of realization should not be adjusted for the implicit time value of money if the consideration will be classified as a current asset. However, in circumstances where consideration is received in advance of a sale and a liability is recognized (typically captioned as unearned revenue or customer advances), we do not believe that the amount of revenue recognized when the flow of the product occurs should be adjusted for the implicit time value of money. We use financial statements of existing and potential customers for credit granting purposes. We believe that we would be misled by a financial statement prepared according to Example 22. Specifically, we would make a credit decision assuming that the customer was generating operational sales at the rate of \$8,800 and was accordingly realizing this amount in cash from its sales and was obtaining the higher reported gross margin percentage than the true, actual cash gross margin percentage. This is misleading to us as users.

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?

Q7: While we do not believe that the starting point for recognizing revenue is to first recognize and measure contracts, we do agree that the allocation should be based on the relative standalone selling price basis. However, we define standalone selling price as exit price. Furthermore, as we have stated in Q1 and Q2 above, not all products and services that might “standalone” should be automatically separately recognized and measured.

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?

Q8: As stated in our response to Q1, we disagree with the independently presented classification rules of costs as either assets or expenses required by paragraph 57. We reiterate our view that operational performance (the operating earnings reported in the income statement) has primacy for private company financial statement users and the matching principle is integral to assessing this operation performance.

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

Q9: Please see our comments in Q8. We agree with the enumeration of these costs, but we disagree with the classification of these costs as assets or expenses independently of recognizing associated revenue. We disagree with the requirements of paragraph 54 to recognize a liability and corresponding expense for onerous costs. We agree with the requirements of paragraph 55 that an impairment of an existing asset related to a contract should be recognized, but for private company financial statement users, under a qualitative characteristic of conservatism and not by active testing for impairments.

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 our response under Q12.

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 our response under Q12.

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?

Q10 (also 11 and 12): We agree that the objective of the Boards' proposed disclosure requirements in Paragraphs 69 – 83 will likely meet the needs of equity analysts of public companies who will use the information to determine the present value of probability adjusted future cash flows from contracts and obligations and the variability of those cash flows due to risk. We wonder, of course, on behalf of these equity analysts why these newly discovered assets and obligations arising from entering into contracts are not just placed onto the public company balance sheet along with the other present values of forecasted future flows instead of accounted for as "off balance sheet" items. However, as we have continued to point out, the demand for this type of disclosure is from this certain category of public company financial statement users and "general purpose" has become defined as generally for these users and to the detriment of private company financial statement users who are not demanding these disclosures. As we have recommended in the financial presentation project, we encourage the FASB to apply these very

similarly structured revenue disclosures to public companies only. There is no demand for this information from private company financial statement users that justifies compelling these risk-adjusted future cash flow projections to be placed into external private company financial reports.

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.

Q13: The FAF/AICPA/NASBA Blue Ribbon Panel (BRP) will issue its formal report on accounting standards for private companies to the FAF around the end of this year. As stated in FEI's letter to FASB's Chairman Herz dated July 22, 2010, we are concerned about the coordination of effective dates for new pronouncements with the effective dates of any enacted recommendations of the BRP on standard setting for private companies. This includes the potential for the confusion of (and resulting disservice to) private company financial statement users in their attempts to comprehend inconsistently recognized revenue in sequential private company financial reports issued under (a) the current revenue recognition standard, (b) the proposed Exposure Draft, and (c) any new standards issued for private companies resulting from the recommendations of the BRP. Therefore, as outlined in FEI's letter, CPC-S recommends that the FASB defer for a minimum of three years the effective date of this ED for nonpublic entities. Also, as stated in the letter, in addition to a deferral of this ED, we are not opposed to the FASB providing an option for early adoption (i.e. on the same effective date as public companies) to nonpublic entities that might prefer to decline the deferred effective date.

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?

Q14: While we appreciate the guidance, and in general support the policy of the FASB issuing useful guidance, our views of revenue recognition differ substantially from the ED proposal used in the guidance.

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?

Q15: We disagree with the proposed accounting for warranties and accordingly the need for a distinction for the two types of warranties. We believe that warranty obligations may give rise to liabilities and that liabilities resulting from warranties should be recognized separately from revenue recognition and should follow the existing recognition, measurement and disclosure principles for liabilities.

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?

Q16: We do not believe that the basis for recognizing revenue of a license is a performance obligation, whether exclusive or non-exclusive. We believe that all revenue transactions engaged in by an entity are intended by the entity to result in realization. When a customer has been given a contractual right to use an entity's asset, we believe that the entity should look to the timing and pattern of expected realization, allowing for normal credit terms, to determine when to recognize revenue. Only those performance obligations that meet the definition of a liability should be recognized, but recognized as liabilities and not as an adjustment of revenue.

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?

Q17: While we do not agree with the revenue recognition standard proposed by this ED, we do believe that accounting for the gain or loss on the sale of some nonfinancial assets should follow the recognition and measurement principles as defined in our definition of revenue contained in our General Comments.

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?

Q18: We have expressed our views in the General Comments section of this comment letter. Accordingly, our overall view is that the ED should not be applied to private company financial statements.

Thank you for considering our comments. If you have any questions or wish to discuss this letter, please feel free to contact me at (704) 365-7382 or by email at gwbeckwith@NationalGypsum.com, or Ronald Wei at FEI (973) 765-1025 or by email at rwei@financialexecutives.org.

Sincerely,

A handwritten signature in black ink, appearing to read "George W. Beckwith". The signature is written in a cursive, flowing style.

George W. Beckwith, Vice Chair

Committee on Private Company Standards
Financial Executives International