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

Dear Sir or Madam:

Re: File Reference No. 1820-100

Mayer Hoffman McCann, P.C. (MHM) welcomes the opportunity to comment on the Proposed Accounting Standards Update, Revenue Recognition, *Revenue from Contracts with Customers* (Topic 605) (the Exposure Draft).

We support the Financial Accounting Standard Board's (Board) convergence efforts and its efforts to address the inconsistencies and weaknesses that currently exist in revenue recognition standards and practices. We also agree with the Board that a more robust revenue recognition framework will improve the comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. Although we believe the reduction in the sheer number of accounting pronouncements pertaining to revenue recognition will help simplify the preparation of financial statements; we are concerned that the Exposure Draft introduces a significant number of new concepts that that may prove difficult to implement in practice.

In general, we support the contract-based asset and liability approach proposed by the Board. We also support the continued movement towards the issuance of principles based standards. While we acknowledge that a principles based standard can be rendered ineffective and "rules based" when excessive illustrative guidance is presented, we believe the illustrative application examples presented in the Exposure Draft are helpful to financial statement preparers and auditors alike; and we recommend the Board retain such examples in the final standard. The remainder of this letter presents our observations on certain other matters related to Exposure Draft.

Combination and Segmentation of Contracts

We agree with the overall premise that contracts should be subject to combination or segmentation. However, in certain situations it is unclear whether or how the application of the segmentation principles would produce a different accounting result than simply identifying an additional performance obligation. We request the Board provide clarification on how it believes the segmentation principles interact with the identification of separate performance obligations (if in fact they are intended to interact).

Identification of Performance Obligations

The requirement to identify performance obligations based on whether the goods or services are "distinct" will require significant judgment and may result in overly difficult implementation issues. When goods and services

are sold separately, the answer is typically straightforward (e.g., typically a performance obligation is identified). However, often goods and services are not sold separately and therefore it must be determined whether the goods or services can be sold separately. In order to conclude that goods or services can be sold separately; the Exposure Draft requires that goods or services have a distinct function and possess a distinct profit margin. The distinct function requirement is similar to the standalone value concept currently found in ASC 605-25, and therefore is unlikely to change current practice. However, the requirement for a distinct profit margin is a new concept for arrangements currently accounted for under ASC 605-25 and is a likely “stumbling block” in the identification of separate performance obligations. The impact related to this issue may be more prevalent for entities that sell software or other intangible products. Many of these entities do not sell their products on a standalone basis and therefore may be significantly impacted by the distinct profit margin requirement. For example, a typical software arrangement (e.g., software and post contract customer support) that is always sold together may result in the identification of a single performance obligation and therefore an accounting treatment that differs from the underlying economics of the transaction. Given the Board's recent focus on removing the inconsistency between accounting and the economics of a transaction (as evidenced by the issuance of ASU No. 2009-13 *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements* and ASU 2009-14 *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements*), this would appear to be an unintended consequence of the distinct profit margin requirement.

We recommend the Board consider whether the proposed requirement for a distinct profit margin should be modified or replaced with guidance that provides flexibility in the determination of whether goods or services have a distinct profit margin. This would be particularly helpful in those instances where cost is not a significant factor in the determination of price and therefore profit margin.

In addition to the implementation issued discussed above, certain industries routinely utilize contracts that result in the identification of a significant number of activities that might be considered distinct in nature (and therefore qualify as a separate performance obligation). Such contracts are typical in the construction industry and other industries where entities commonly perform under long-term contracts. We recommend the Board consider whether it would significantly improve the operational effectiveness of the guidance pertaining to performance obligations by requiring that only “substantive” activities be identified as performance obligations. The requirement to first identify performance obligations and then aggregate them into “distinct” performance obligations will require significant judgment and may not always reflect the economics of the transaction or contract. We are concerned that this will pose a significant challenge, and in practice may not be operational for some long-term construction contracts. The proposed requirements may also result in significant diversity in practice thereby reducing the comparability of reported results within industries that frequently use contracts that identify multiple activities. We believe the development of separate criteria to assist in the identification of substantive performance obligations would likely reduce the burden of implementation and improve comparability by providing a consistent approach for identifying the significant activities that typically become performance obligations under these types of contracts.

Determination of the Transaction Price

Under the Exposure Draft, the treatment of variable consideration will likely result in a significant change from past practice. Current GAAP leans heavily on a “predictive” approach. Generally, revenue related to a contingency is not recognized until the contingency is resolved. The Exposure Draft requires a probability weighted estimate that will result in earlier revenue recognition for some industries (e.g., biotechnology milestone arrangements) but may result in later recognition for others. While we generally agree with the proposal, we question whether a weighted average probability approach is appropriate in all situations. We recommend the Board consider whether the prescriptive use of the weighted average probability approach

may result in premature revenue recognition or counterintuitive results such as recognizing an amount that is not a settlement alternative under the actual terms of the contract. The use of management's best estimate may under certain conditions represent a better alternative and should be considered in addition to the weighted average probability approach. Clear and transparent disclosure of the reasons why management has elected to use an estimation technique other than a weighted average probability approach should be required in the notes to the financial statements.

In a departure from current practice, the Exposure Draft requires adjustment of the transaction price to reflect an estimate of amounts deemed uncollectible under the terms of the arrangement. Under the current "culmination of earnings process" model, assessing the probability of collection is a criterion for recognition and no revenue is recognized unless it is probable that the amount due under the terms of the arrangement is collectible. Under the proposed model the collectability of amounts due becomes a measurement consideration. We are concerned that some revenue might be recognized even when substantial uncertainty exists regarding the collectability of amounts due. This seems counterintuitive to us; and we believe that an entity should have at least "reasonable assurance" it will collect the arrangement consideration prior to the recognition of any revenue related to the arrangement.

Retrospective Application

While it clear that retrospective application will provide useful information to the users of financial statements, it is likely that this requirement will be burdensome for many entities. Those entities with significant complex multiple element arrangements and/or complex long-term contracts may be particularly impacted by the requirement. Retrospective application may require entities to maintain two sets of books during the retrospective period likely resulting in a significant investment in time and expense. We encourage the Board to revisit the transition method debate and ensure that the cost of retrospective application will truly provide the benefits anticipated by the Board. We encourage the Board to consider whether the flexible transition guidance provided under ASU No. 2009-13 *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements*, and ASU 2009-14 *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements* might provide a suitable alternative to full retrospective application.

While the Board has exempted private companies from certain provisions of its standards in the past and/or provided extended transition periods, should the Board retain its decision to require the full retrospective application, we would favor an alternative for private companies which would encompass the suggestions we have made above.

Other Issues

The Exposure Draft requires loss recognition related to "onerous" contracts. This principle is similar to the "forward loss" principle required under current practice. However, we note that the Exposure Draft requires the analysis to be performed at the performance obligation level, leading to the possibility that "day-one" losses will be frequently encountered. Although there are a variety of reasons this might occur, we believe it is a relatively common practice for entities to price certain goods and/or services in a manner that would trigger the "onerous" contract accounting requirements, particularly when low margin goods and/or services are included in multiple element arrangements or when related pricing decisions reflect the desire to foster or maintain customer relationships. We wonder whether the users of financial statements will truly benefit from the disclosure of more granular information at the performance obligation level or whether such information is just as valuable to financial statement users when presented on a contract by contract basis. We believe the

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Board should consider whether the benefits truly outweigh the cost of providing the aforementioned information at the disaggregated level.

Presentation and Disclosure

We agree with the Exposure Draft's requirement to disclose information related to revenue on a disaggregated basis. As previously stated, we support the use of principle based standards and understand the Board's reluctance to prescribe the exact information to be disclosed on a disaggregated basis. However, we believe that the final standard should include guidance related to how the entity determines the categories of revenue to be disclosed. We are concerned that without at least some guidance, practice will be exceedingly diverse and the information disclosed will not fully achieve the goal of comparability that is a cornerstone of good financial reporting.

We appreciate the opportunity to provide comments on the Exposure Draft. Please contact James Comito (858.795.2029) if you have any questions.

Respectfully Submitted,

Mayer Hoffman McCann P.C.