# Students from the Masters of Science in Accounting Program Indiana University Indianapolis Kelley School of Business 801 W. Michigan St. Indianapolis, IN 46202-5151

25 October 2010

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

RE: Revenue Recognition (Topic 605) File Reference Number: 1820-100

#### Dear Director:

Thank you for the opportunity to comment on the Proposed Accounting Standards Update on Revenue Recognition (Topic 605). As future professionals in this industry we sincerely appreciate the Boards' efforts to work together to create a universal set of standards and guidance addressing the recognition of revenue arising from contracts. We present responses to the issues raised in the exposure draft in the appendix detailed.

We generally agree with the guidance provided. However, we believe additional guidance in the form of examples and definitions are necessary in order for implementation to be effective. Specifically, a universal definition of 'control' and items 'explicitly chargeable' and 'exclusivity' are warranted. We disagree that credit risk should affect the amount of revenue or that revenue should be disaggregated in order to show effects of economic factors.

Sincerely,

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# Recognition of Revenue

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?

We agree with utilizing the principle of price interdependence to help determine whether an entity should combine or segment contracts. It is reasonable to allow entities to combine and segment contracts as they share qualities. All factors from paragraph 13 (a), (b), (c) should be evaluated to determine if two contracts do indeed have interdependent prices. However, we do think that more guidance should be provided when defining price interdependence. As we are going towards a more principles-based standards framework, fewer rules based criteria should be used to describe price interdependence. We believe that doing this will improve comparability as entities make decisions on how to combine or segment contracts. In addition, we believe that there should not be a single approach for the treatment of contract modifications. Many different circumstances arise which can justify different treatments. Therefore, we believe that the current guidance for contract modification must be improved in the final standard to greatly improve the understandability for financial users. Specifically, we think more principles-based guidance that notes the different circumstances for contract modifications should be provided.

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 agree that there should be a principle to determine when a good or service is distinct. However, this exposure draft is not consistent with principles-based standards. The criteria given for determining whether a good or service is distinct is rules-based. With the appropriate principles-based guidance, distinct performance obligations will be understood and displayed in a much more consistent manner. This type of guidance will allow an entity to apply the guidance based on its own specific circumstances.

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?

We agree that control of a promised good or service should be transferred to a customer in order to satisfy a performance obligation. However, we do not believe that the implementation guidance provided is sufficient. We believe more examples are needed. In addition, we believe there should be a wide spread definition of control put in one place. There is not a general understanding or comprehension of control and until that is established this principle will not be effective. There are many ways to interpret when the transfer of control takes place. Therefore to improve consistency and comparability throughout financial reporting, defining when control transfers to the customer requires clarification.

#### Measurement of Revenue

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 approaches do you suggest for recognizing revenue when the transaction price is variable and why?

We agree that transaction prices that are not certain should only be recognized if the can be reasonably estimated. However, we are concerned that the probability-weighted method identified in paragraph 38 does not sufficiently provide guidance for implementation. If this method is administered, additional disclosure requirements will be necessary in order to support comparability.

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 affect how much revenue is recognized. While credit risk is an important aspect affecting an economic entity, it should not be a reduction of revenue. Rather, it should be treated as bad debt expense as in current GAAP.

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?

We agree that if the contract includes a material financing component it should reflect the time value of money. This is a reasonable proposal as interest income and expense are not derived from the performance obligations of the contract but are a result of the financing component alone. In addition, using a basis of materiality indicates that it should only be applied when relevant to users of financial statements. We also concur that credit risk should be reflected in the interest rate, and reiterate that it should not be used as a measurement factor as prescribed in paragraph 43 (see our response to Question 5).

We believe that more specificity is needed in terms of what constitutes "significantly before or significantly after" or that the measure of significance will be determined by the entity based on common business practices.

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?

We agree that the transaction price should be allocated to separate performance obligations in a contract. Identifying separate performance obligations and allocating the transaction price according to standalone selling price, whether given or estimated, will provide the most complete and faithfully represented information in the financial statements, thus increasing transparency. However, we do believe that additional guidance is necessary in order to allow for situations when separate performance obligations are not easily distinguished.

# **Contract Costs**

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?

We agree that the proposed guidance is operational in regards to the costs of fulfilling a contract because it defines the criteria by which an entity can recognize an asset, if those costs are directly related to the asset. This accounting is consistent with the current accounting practice of treating costs directly related to the asset. However, another cost criteria that will result in recognizing an asset is when the costs, "generate or enhance resources of the entity that will be used in

satisfying performance obligations in the future" (Par 57). This statement seems to be inconsistent with the current working definition of an asset as agreed by both Boards on their ongoing Phase B project because of the need for an entity to satisfy future obligations. Nonetheless, taken as whole, the proposed guidance on accounting for the costs of fulfilling a contract is operational as it takes into account, for example, direct costs that can be recognized as an asset and is in tandem with the agreed working definition of an asset.

More guidance will need to be provided so that the cost criteria are consistent with Phase B and the conceptual framework in its entirety. Furthermore, the proposed guidance is not sufficient because of need for an entity to refer to three additional topics (Topic 330, Topic 360 and Topic 985) to determine whether contract costs are eligible to be recognized as an asset. We recommend that all the criteria for eligible costs be put in one place – Topic 605, eliminating the need to scrutinize four various topics for eligible costs.

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?

We agree that most of the costs specified should be included for recognizing an asset as the costs directly relate to satisfying performance obligations. We do not agree that costs that are explicitly chargeable to the customer under the contract and other costs that are incurred only because the entity enters into a contract should be included. These costs will be prone to different interpretations which can lead to different interpretations and application across firms, and therefore, in some cases, the information may not reflect faithful representation. For the purposes of clarity, a comprehensive and clear definition should be provided for what constitutes "explicitly chargeable."

We agree with the exposure draft, that "costs of abnormal amounts of wasted materials, labor, or other resources used to fulfill the contract" shall be expensed as incurred. The term abnormal is very subjective and a clear definition and examples will help provide guidance of what is abnormal. Taking into account the resource constraints faced by entities, it will be difficult to recognize abnormal wasted labor let alone measure it.

#### Disclosure

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?

We agree that the proposed disclosure requirements will aid users in understanding the amount, timing and uncertainty of revenue and cash flows arising from contracts. We believe that if the disclosures are implemented with the level of detail that the Boards intend, they will aid in comprehension of revenues from contracts and thus faithfully represent the economic substance of the transaction. However, we have concerns regarding the potential cost implications of implementing the disclosure. In determining the cost/benefit tradeoff, the costs of implementing the disclosures will be borne by the entities, while the benefits will be useful to financial statement users.

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?

We agree an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for long-term contracts. This is useful information and it increases comparability among companies, especially those within the same industry.

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?

We do not agree that an entity should disaggregate revenue into categories based on economic factors. Disaggregating revenue into categories will not add value to the financial statements as the information already exists. We believe that this requirement is unnecessarily burdensome, and encourage both Boards to remain consistent with principles-based standards and the conceptual framework.

#### **Effective Date and Transition**

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 agree that the guidance should be applied retrospectively. This method will allow users to see more consistency in prior years' financial statements and give a better understanding of current financial position. We believe this approach is vital in order to avoid misunderstandings of any possible material effects of changes in revenue recognition as a result of the proposed guidance. We do not think there is any alternative or lower cost method that would adequately preserve trend information about revenue.

## **Implementation Guidance**

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?

With exception to the items noted previously, we believe the guidance for implementation is sufficient. Although we recognize the Boards' objective to provide principles rather than rules, additional examples, guidance, and definitions provided by the Board would contribute to consistent reporting and increase comparability.

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

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?

The proposed distinction between warranties is clear; however, we are unclear on the benefit of the distinction. We are concerned that the different measurement treatments coupled with the amount of judgment involved in classification could lead to incorrect and inconsistent classification. This rules-approach moves away from principles-based guidance.

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 do not agree that the pattern of revenue recognition should depend on the exclusivity of the license. The application of exclusivity varies among industries as well as from license to license. In order for this principle to be effectively implemented, a universal definition of exclusivity for the purpose of revenue recognition is required. The timing of the transfer of control is more important to the revenue pattern than the exclusive or non-exclusive right to use the license.

### **Consequential Amendments**

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 agree that gain or loss on the sale of some nonfinancial assets should be accounted for with the recognition and measurement principles of the proposed revenue model. Although these gains or losses "are not an output of the entity's ordinary activities" according to paragraph IN6, following the proposed revenue model will provide consistency in financial statements for recognition and measurement of these revenues. It will also lead to increased comparability in revenues arising from the same source among different entities. According to the article from Accounting Research Manager addressing this proposal, the Boards are attempting to create a comprehensive model for revenue recognition and eliminate inconsistencies. This application will support the Boards' purpose.

# Nonpublic Entities

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?

We believe that the proposed guidance, if adopted by the Boards, should not be altered for nonpublic entities. However, we do not believe that nonpublic entities should be subject to the same timing constraints, and that additional time should be given in order to overcome possible resource or cost constraints.