

2011-230 Comment Letter No. 85

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March 13, 2012

# Submitted via email (to director@fasb.org)

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

File Reference No. 2011-230

#### **Exposure Draft, Revenue from Contracts with Customers**

Technical Director, Board Members, and Staff:

Dell appreciates the opportunity to comment on the Exposure Draft: Revenue from Contracts with Customers. We understand the revisions did not necessitate a reexposure, but appreciate the Boards decision to reexpose. Ultimately the replacement of the current US multiple rules-based standards with a single set of high-quality globally accepted accounting standards will help improve consistency, simplify and enhance comparability. We continue to support the convergence of US GAAP and IFRS. We applaud the Boards for the efforts that have gone into this project, it is unprecedented and as a result of the coordinated work and outreach we have a high quality Exposure Draft.

Dell is a global information technology company that offers its customers a broad range of solutions and services delivered directly by Dell and through other distribution channels. As a leading technology company, we offer a broad range of product categories, including mobility products, desktop PCs, software and peripherals, servers and networking, and storage. Our service solutions include a comprehensive range of configurable IT and business related services, including support and deployment; infrastructure, cloud, and security; and applications and business process services. Dell is a \$60 billion multinational company that enters into a variety of arrangements with customers which include long-term service contracts, installations, software solutions, and transactional orders.

Our customers typically have a master agreement, this contract would generally cover what the customer plans to buy. It would not be specific as to exact quantities or services and would have no specific contractual commitment either by Dell or its customer. Customers use these contracts as overarching agreements and provide either purchase orders (PO) or statements of work (SOW) to detail the exact services or product they will purchase. Even after the PO or SOW is executed the terms may still be cancelable.

Unfulfilled orders can typically be canceled by the customer. The terms of the signed services contracts are subject to change and are affected by terminations, changes in the scope of services, and changes to other factors that could impact the value of the contract. For these and other reasons, it is not reasonably practicable to estimate the amount of future revenue included in executed contracts.

Because of the predominance of cancelable provisions and items noted above, under the new model Dell anticipates that it will typically have a contract asset or liability when either Dell has received cash in advance of providing a service or product or Dell provides a service or product in advance of receiving cash.

While we continue to support the Boards' efforts to drive to one conceptual model and we are generally supportive of the proposed model, we do have some comments on the proposed standard. These primarily include the disclosures required, time value of money, and transition. Further discussions of these topics are in the following paragraphs and our detailed responses to the questions on the Exposure Draft are included in the Appendix to this letter.

#### **Disclosures**

We applaud the Boards intent to address disclosures, but we have concerns on the approach. Disclosures should provide useful information to financial statement users. Useful information should not translate into more pages of mandatory disclosures. Revenue is the driver of the business and the disclosure requirements should be holistic and based on how management runs and drives the business. This is more useful than a list of prescriptive requirements which is a contradiction to a principles based accounting standard. As mentioned in our previous comment letter in 2010 the disclosures are much more extensive than those required in current practice. While there are not many disclosure requirements required today for revenue, quality is better than quantity. Many of the disclosure objectives can be reached through policy disclosure and current disclosure guidelines.

## • Disaggregation of Revenue

This proposal does provide information to better understand the composition of revenue; however, it is too granular and does not take into consideration other disclosure requirements. We recognize one of the difficulties of one converged

standard is that there may be existing rules under FASB that are not applicable under IASB. Disaggregation of revenue is a good example of this, under the current guidance of ASC Topic 280, Segment Reporting, issuers are required to present disaggregated revenue data as it is presented to the Chief Operating Decision Maker ("CODM"). We believe that the revenue literature should reference ASC 280, if applicable, as an appropriate method of revenue disaggregation. For users of our financial statements, we believe the revenue disclosures we provide under the ASC 280 guidance depicts the nature, amount, timing, and uncertainty associated with our revenue transactions. Accordingly, we believe that the principles-based guidance in current practice provides more meaningful disclosures for financial statement users than standardized disclosure requirements would permit. Disclosures similar to the current guidance will provide users of the financial statements information at a level presented to the CODM and will be easier to implement as systems are currently designed to capture and report this data. Revisions to add further granularity will require additional processes and system changes to accommodate reporting. These disclosures would result in additional confusion and lack of clarity for investors because it would be inconsistent with how the business is run and decisions are made.

• Reconciliation of Contract Balances and Onerous Performance Obligations
Consistent with our previous comment letter, we disagree with the Boards' decision to evaluate onerous performance obligations at the performance obligation level, rather than at the contract level. We believe that evaluating onerous performance obligations at the contract level represents a more meaningful reflection of the economic transaction. Transactions are typically analyzed at the contract level when negotiated and throughout the contract term. If a loss is identified the entire contract is considered and potentially renegotiated. These considerations are not made based on the performance obligation and recognizing a loss would misrepresent the current and future results of the contract. We recommend analysis at the contract level and when booked, the loss should be allocated to performance obligation that is at a loss.

# • Remaining Performance Obligations

We do not agree that general, qualitative discussions regarding the period of time that entities expect to recognize their deferred revenue balance would be useful to investors and recommend the Boards remove this requirement. Investors would have an expectation of remaining performance obligations to be future revenue to be recognized. As we currently disclose in our financial statements our backlog will not necessarily translate into net revenue in a subsequent period as an unfilled order or change in service may change the value of revenue recognized.

Due to the multitude of contract types as well as the consistently evolving nature of our business, we would discourage the board from requiring this information at a granular level. We believe that the additional cost to prepare and audit this information would far outweigh any perceived benefit to users. If this disclosure is still to be required by the Boards we ask this is an annual requirement rather than an interim to avoid additional burden for a reporting requirement that could be deceiving to users of the financial statements.

## **Interim Reporting**

We suggest annual disclosures with interim updates for material changes. This will provide relevant material information to the users of the financial statements while balancing the ongoing costs of companies to comply with the disclosure requirements. As revenue varies significantly across entities, we believe the overarching principles of ASC Topic 270, Interim Reporting, should apply. Although this will lead to diversity in practice of what a significant change is, this lack of comparability exists in all interim disclosures. In addition, not applying these principles will lead to the disclosure of information that is not meaningful for investors, as requiring the disclosure of information that is "expected to change" is very different from the principle of disclosing information on an interim basis that has "significantly changed from the prior reporting period."

In addition, we suggest only requiring these disclosures on an annual basis because of the reduced time requirement for filing interim reports with the SEC. Requiring all of these disclosures on an a quarterly basis will put strain on the accounting organization of issuers as well as their external auditors, who would be required to review these disclosures, many of which are more subjective in nature than traditional disclosures.

## Time Value of Money

This concept is theoretical and does not hold to the concept of what the entity is entitled to receive. It also adds a high degree of estimation to the revenue line. The Boards should only apply this concept to explicit financing transactions. As currently proposed, the time value of money would have unintended consequences and end up being applied to implicit financing transactions. For example, warranty transactions are not transactions a customer has an expectation of financing. Even though these services are paid in advance a customer and company do not enter into a warranty transaction with the intent of financing. When applying paragraph 59 one may interpret application of the time value of money is necessary. The Boards should consider there are other factors that contribute to the variation of consideration as referenced in paragraph 59(b). Customers pay for the warranty in advance in order to obtain service. Prices will change as the product matures. If the customer waits to pay for the warranty until right before the expiration the price fluctuation would primarily be due to market conditions of the product, not related to a financing

component of pricing. In addition we are paying for warranty replacement parts potentially at the beginning and throughout the warranty life. If this applies to transactional services like warranty it would be impractical to implement this, for a company our size it would apply to millions of transactions. Most companies will likely have to develop a top level model adjustment to calculate. This will introduce additional subjectivity and lack of clarity to the revenue line. For example, companies would likely use different rates and different applications in countries with varying costs of capital Examples should be provided in the literature to help companies apply in practice and interpret.

The Boards have not considered the broader impacts to revenue accounting. While the revenue will be adjusted for time value of money the associated cost will not be adjusted accordingly. We often purchase inventory, services, or maintenance in advance for multiyear services contracts. The Boards need to consider the practical application and take a holistic approach to contracts with significant financing components.

Therefore, we believe time value of money should be removed from the standard. If the Boards leave the time value of money concept in the standard, it is imperative that the Boards apply it to explicit financing transactions only. Application to implicit transactions could potentially not model the transaction intent. The expedients should remain. The final guidance should contain some clearer guidance or examples on application to payment terms that may be "exempted" by paragraph BC147.

## **Effective Date and Transition**

Retrospective application does provide the users of the financial statements with additional information and has substantial costs, complexity, and time associated with it. It is also not consistent with previous transition method proposals and may not provide the most meaningful approach and implementation for companies. The most applicable information is the most current information.

Full retrospective application would increase the implementation time for companies due to the time necessary to review and gather data. Companies with complex arrangements or longer-term contracts would have very challenging implementation. Most companies will not run dual systems, the functionality does not exist within today's current capabilities. The costs will be prohibitive and will potentially lead to offline processes and the use of estimates for prior year transactions.

Additional items also need to be considered. For example, potential impact to tax filings. Our book to tax income would need to be reevaluated on IRS, state filings, and international returns. Dell has almost 300 legal entities world-wide and files approximately 500 state returns that would require evaluation and potentially

require amended tax filings for each year restated. On the federal return an amended return would potentially need to occur to reconcile the restated book income to tax income. If the federal return is amended then there is an expectation from the states that the state returns would also be amended. A lot of state returns have apportionment factors for determining the taxable income for that state and may also need to be assessed for amendments. All the various methods of the international returns would also need to be assessed for potential impact and amendments.

Our alternative transition method proposal is to utilize similar transition guidance allowed in Update No 2009-13 Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements and Update No. 2009-14 Software (Topic 985): Certain Revenue Arrangements That Include Software Elements. This would require prospective application and disclosure of comparative information for the period immediately preceding the change. Companies could then elect retrospective application, if appropriate. This method is preferred because it is consistent with guidance in the past, provides comparative information, and allows companies to implement as fits their business. It is a good balance between implementation cost versus providing transition information to investors. This transition methodology was well accepted by both companies and investors. It was successful because companies considered the impact and implications to implementation and were able to manage based on what was the best decision for the company and its shareholders.

During the time of implementation investors will have a challenge understanding the data regardless of three year history, one year disclosure, or prospective treatment. The key for a transition is to provide investors the necessary information while balancing the cost burden of a company. The current retroactive proposal would require three years of data. Data gathering would require lead time to select and update policies, hire resources, and change systems. Also that length of time would require dual reporting systems under current GAAP and the proposed model. The older data would be less relevant. Allowing similar implementation guidance to past revenue guidance would provide that balance.

Finally companies should be allowed to determine the adoption time period that is applicable to their company. Early adoption should be permitted in the standard.

We appreciate the opportunity to submit these comments on this Exposure Draft. We are available to help and to further discuss the additional updates that we believe are necessary to the model. If you have any questions, please contact me at (512) 728-8092.

Sincerely,

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# **Appendix**

#### Question 1:

Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognizes revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

## Dell's Response:

We agree with the proposal to include guidance to recognize revenue over time as the performance obligation is satisfied over time. Paragraphs 35 and 36 will result in accounting that reflects the underlying economics in most cases.

We are concerned about the misinterpretation of guidance of the identification of separate performance obligations when applying the concept of "highly interrelated". In the technology industry we routinely sell services with installation or long-term services. Our understanding is paragraph 29 was added in response to the construction and manufacturing industries that are currently applying ASC 605-35 *Construction-Type and Production-Type Contracts*.

Our concern is that a bundled transaction with a combination of hardware, software, and services could have a different accounting treatment simply because of the way it is sold to the customer. Further clarification or examples would be helpful to further define "highly interrelated". Clarification could include implementation guidance on application in various industries in various circumstances.

We agree with the guidance on revenue recognized over time but we feel there could be additional examples or clarification provided on services that are considered stand ready and provided over a defined period of time. For example, warranty sold separately and software post contract support. These services cover a specific period of time and the company is required to perform as the customer has problems, questions, or claims. With the software post contract support we also provide when and if available software upgrades, typically for bug fixes or additions to functionality. Because the upgrades are when and if available only and not specifically promised to the customer, the specific upgraded functionality is not marketed to the customer with the original sale, instead the product is marketed as a services support product. These upgrades and services are provided as needed and should be recognized over the contract term. When you consider the specific customer level the customer will be receiving services or upgrades at specific points in time but Dell has to be ready to answer at all times, provide services at all times, and provide upgrades when and if the

technology exists. Therefore the requirement to stand ready should require that the revenue be recognized ratably over time.

## Question 2:

Paragraphs 68 and 69 state that an entity would apply Topic 310 (or IFRS 9, if applicable) to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

## Dell's Response:

We agree with the proposal to present uncollectible amounts related to a customer's credit risk as adjacent to revenue. It is more transparent and easier to apply in practice if all changes are through one line on the income statement. The calculation of credit risk should be similar to practice today in order to allow for a general reserve as well as specific customer reserves.

### Question 3:

Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognizes to date should not exceed the amount to which the entity is reasonable assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognize for satisfied performance obligations? If not, what alternative constraint to you recommend and why?

#### Dell's Response:

We agree with the proposal to constrain the amount of revenue an entity would recognize for satisfied performance obligations. The indicators provided appear appropriate to determine if an entity's experience is not predictive of the amount of consideration to which an entity will be entitled to receive.

#### Question 4:

For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognize a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

## Dell's Response:

In our previous comment letter we stated profitability is often managed on a contractual level; therefore under one customer agreement there could be a specific performance obligation that is profitable, offset by another performance obligation that is at a loss.

The proposed standard would require companies to perform an onerous loss review at the performance obligation level and recognize a liability and corresponding expense for onerous performance obligations greater than one year. Profitability is often managed on a contractual level; therefore under one customer agreement there could be a specific performance obligation that is profitable, offset by another performance obligation that is at a loss. In addition, if future losses are anticipated, often it is because of a change in the original contract assumptions and it is renegotiated with the customer. Reviewing at the performance obligation level does not provide useful information for users of the financial statements, because contracts are negotiated in totality and losses may be offset by gains. By recording losses upfront and separate from gain recognition a company will be overstating future period margins.

An alternative which is more representative of the economics of the transaction is evaluating the onerous loss at the contract level instead of the detailed performance obligation level. Evaluating at the contract level will be more reflective of the economics of the transaction. For example, there may be some elements of the contract sold at a loss and others that are sold for a gain, both of which are negotiated together. Overall the contract is in a gain position even though one of the performance obligations may be at a loss.

The Boards should provide in the standard the consideration of the relationship and experience with the customer. The current proposal seems to just reevaluate costs. Typically with longer term contracts a company will have the ability to recover some of these costs through renegotiations with the customer and have the ability to revise the transaction price. The Boards should include the ability to not just reevaluate costs but to also reevaluate the transaction price.

The timing of recognizing the losses needs to be considered. These types of losses are losses from future operations that have not yet been incurred and therefore one could argue there is not a true liability at any given reporting date.

Liabilities should be recognized and disclosed in accordance with the ASC 450: Accounting for Contingencies Requirements. The liability is not simply incurred by signing the contract, but as the party performs their respective performance obligation. Loss recognition should occur when there is a high probability the company will incur a loss on the contract. The standard should contemplate other factors that will impact probability of the loss. For example, consider the ability and historical practice of renegotiating the contract or the ability to cancel the contract. The current contingency disclosure requirements of potential significant loss contracts provide the necessary information to users.

#### Question 5:

The Boards propose to amend Topic 270 and IAS 34 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial statements. The disclosures that would be required (if material) are:

- 1. The disaggregation of revenue (paragraphs 114-116)
- 2. A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- 3. An analysis of the entity's remaining performance obligations (paragraphs 119-121)
- 4. Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
- 5. A tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial statements? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriate balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial statements.

#### **Dell's Response:**

As commented in our cover letter, we do not agree with amendment to Topic 270 to include the additional disclosures in interim disclosures. We also question whether the information will be useful for investors. An overall review of disclosures needs to be done in conjunction with the disclosure framework project. Even though the disclosure framework project is not a converged project, it is appropriate to review disclosures holistically rather than individually in each standard. The current proposal will not provide as much useful information

as anticipated to investors for the amount of effort required from the preparers to implement and maintain on a regular basis.

## Question 6:

For the transfer of a nonfinancial asset that is not an output of an entity's ordinary activities (for example, property, plant, and equipment within the scope of Topic 360, IAS 16, or IAS 40), the Boards propose amending other standards to require that an entity apply (a) the proposed guidance on control to determine when to derecognize the asset and (b) the proposed measurement guidance to determine the amount of gain or loss to recognize upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement guidance to account for the transfer of nonfinancial assets that are not an output of an entity's ordinary activities? If not, what alternatives do you recommend and why?

## Dell's Response:

As stated in our response in the 2010 exposure draft comment letter, we agree with extending the principles to the sale of operational assets not owned for sale in the ordinary course of business. The Boards should include clear guidance and examples on applicability to the sale of these assets. There should be clear understanding on when the revenue recognition principle applies versus other accounting guidance.

## Other Topics:

#### **Contract Costs:**

We do not agree with the new requirement in the proposed ASU to capitalize incremental costs of obtaining a contract. We believe this should be an accounting policy election. Enabling policy elections will make the ASU applicable across multiply industries and allow a business to decide how and whether the contract costs are meaningful to their business. Tracking the costs to be compliant with the standard would be burdensome and in most cases would not result in a benefit to investors. Any policy elections should be disclosed in the financial statements to allow investors to understand the treatment of contract costs. This will allow companies the ability to track costs as applicable to their business. At Dell tracking all the incremental costs associated with obtaining a contract would require additional system and personnel tracking the costs given the number of contracts that would qualify under this requirement.

## **Warranty Treatment**

We agree with the Boards treatment of standard warranty as a cost accrual versus the previous proposal to consider a separate performance obligation. Standard warranties are closely linked to the delivered product and do not provide the customer with an asset beyond the original product delivery nor do companies view them as revenue generating activities. Warranties vary across industries, countries, and contracts. We agree with including the warranties required by law and if the task is required to be performed in order to perform the standard warranty in accordance with the agreed upon specifications. The current examples are clear and provide additional guidance, however we think additional examples would be helpful to clarify the services that should qualify as a separate performance obligation.

#### **Allocation of Discount**

Although the discount would still be based on relative selling price, there would be a change in current practice as we would need to evaluate if there are bundles sold regularly at a discount prior to allocating a discount. (paragraph 75) We think additional guidance should be provided as to when this is applicable.