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

Via Email to director@fasb.org

RE: File Reference No. 2011-230, Proposed Accounting Standards Update, Revenue Recognition (Topic 605)

Dear Technical Director:

We are pleased to comment on the Financial Accounting Standards Board's (FASB or Board) Proposed Accounting Standards Update, *Revenue Recognition* (ED or Proposed Standard). We are supportive of the FASB's efforts to improve revenue recognition guidance and believe the current ED is a significant improvement from the 2010 exposure draft as well as provides a useful framework to apply its principles across many industries and the many types of activities that generate revenue. While we support issuance of the ED overall, we have some comments and suggestions below, followed by responses to the specific questions in the ED in Attachment A.

Comments and Suggestions

Application to Portfolio of Contracts

Paragraph 6 provides for a practical expedient, whereby an entity may apply the proposed guidance to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the result would not be materially different than applying the guidance to the individual contracts (or performance obligations). Given the principles within the Proposed Standard, it is not clear when an application of this practical expedient would apply. We recommend including an example of when this condition might be met as part of the implementation guidance.

Implementation Guidance Regarding "Single Commercial Objective"

Paragraph 17(a) introduces the term "single commercial objective" which provides a criterion for when to combine two or more contracts. We believe this is an important criterion to evaluate as it will lead to either contracts accounted for individually or on a combined basis as one single commercial objective. Given the importance of this criterion and implications of its determination, we recommend defining the term "single commercial objective" in order to clarify this concept.

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Change Orders and Claims

As discussed in paragraphs BC34d and BC61, respondents from the construction industry previously expressed concern regarding the treatment of change orders in terms of the transaction price. The Board has provided clarification in the background information indicating their intention was not to preclude revenue recognition for unpriced change orders if the scope of the work has been approved and thus the entity has a right to payment for the additional work performed. However, also common in the construction industry are unapproved change orders and claims resulting from project performance. Current guidance addresses change orders at various stages (approved, unpriced, and unapproved) along with proper treatment of claims. Specifically, change orders that are unapproved or in dispute are to be evaluated as claims. The following excerpt from ASC 605-35-25 specifically addresses the current treatment of unapproved change orders and claims:

25-30. Claims are amounts in excess of the agreed contract price (or amounts not included in the original contract price) that a contractor seeks to collect from customers or others for customer-caused delays, errors in specifications and designs, contract terminations, change orders in dispute or unapproved as to both scope and price, or other causes of unanticipated additional costs. Recognition of amounts of additional contract revenue relating to claims is appropriate only if it is probable that the claim will result in additional contract revenue and if the amount can be reliably estimated. Those two requirements are satisfied by the existence of all the following conditions:

- a. The contract or other evidence provides a legal basis for the claim; or legal opinion has been obtained, stating that under the circumstances there is a reasonable basis to support the claim.
- b. Additional costs are caused by circumstances that were unforeseen at the contract date and are not the result of deficiencies in the contractor's performance.
- c. Costs associated with the claim are identifiable or otherwise determinable and are reasonable in view of the work performed.
- d. The evidence supporting the claim is objective and verifiable, not based on management's "feel" for the situation or on unsupported representations.

25-31. If the foregoing requirements are met, revenue from a claim should be recorded only to the extent that contract costs relating to the claim have been incurred. The amounts recorded, if material, should be disclosed in the notes to the financial statements. Costs attributable to claims should be treated as costs of contract performance as incurred.

The Proposed Standard in paragraphs 18 and 19, along with paragraphs BC34d and BC61, specifically address changes that are approved. However, paragraphs 50 through 57 provide guidance for determining the transaction price, including variable consideration and evaluation of the following: "the terms of the contract and its customary business practices" and "the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services." This guidance could be interpreted by some to be consistent with conditions a – d of paragraph 31 in ASC 605-35-25 resulting in entities recognizing some amount of revenue; while others may only consider the "approved" status of change orders as provided by paragraphs 18 and 19, and recognize no revenue.

We recommend providing further clarification to address this common situation either through additional examples or specific requirements within the proposed standard.

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Applying the Input Method to Separate Performance Obligations

Paragraph 46 addresses when to recognize the separate performance obligations that include both goods and services when the customer obtains control of the goods significantly before receiving the services related to those goods. The guidance indicates that "the best depiction of the entity's performance may be for the entity to recognize revenue for the transferred goods in an amount equal to the costs of those goods if both of the following conditions are present at contract inception:" This guidance suggests that when both of these conditions are present that an entity "may" use this method. As such even when both of these conditions are present, an entity may choose not to recognize revenue equal to the costs of those goods, which does not seem appropriate because this is not consistent with the best depiction of how the entity performs under the contract. We recommend that this method should be required when both conditions are present rather than an option to apply. We also note paragraph BC 122 in the basis for conclusions uses the term "should" when describing the Board's view on this topic.

Clarification on Discounting or Not Discounting Onerous Performance Obligations

Paragraph 88 requires the liability for an onerous performance obligation to be measured based on the lowest cost of settling the remaining performance obligation which exceeds the related transaction price. Since an onerous performance obligation is only recorded for a contract that exceeds a term of one year, it is not clear whether the obligation is determined on a discounted or undiscounted basis. We recommend clarifying whether the estimated contract cash flows are discounted or undiscounted.

Cost That Relate Directly to a Contract - Clarifying the Application of Overhead Costs

Paragraph 92 identifies the types of contract costs that should be recorded as an asset, assuming they meet the requirements in paragraph 91. Consistent with our comment on the 2010 exposure draft, we recommend the final standard should specifically indicate if direct labor includes the related overhead costs or not. There is diversity in practice today using current generally accepted accounting principles when certain costs are capitalized and we believe specificity of whether to include overhead costs will result in improved consistency.

Implementation Guidance – Shipment of a Product with Risk of Loss

The example in paragraph IG 63 indicates an entity would allocate a portion of the transaction price to the performance obligation to provide risk coverage (replacement product for lost or damaged product when shipping terms are FOB shipping point) and would recognize revenue as that performance obligation is satisfied. In many circumstances, the common carrier that transports the goods carries insurance related to these goods. We understand many entities may promptly replace damaged or lost goods irrespective of the insurance in order to maintain good customer relationships and because they understand the entity will recover all, if not most of the loss from the common carrier's insurance. For most entities, the exposure to loss is limited by the small individual shipments where they apply this practice. We recommend the Board consider whether the final ASU should either include a practical expedient related to the application of this concept or exclude the concept because the cost of applying the concept outweigh the benefits in many situations.

Implementation Guidance - Experience with Similar Types of Contracts is Predictive

Paragraph IG 71 – example 14 indicates that an entity can estimate future commissions that are likely to be received based on past evidence of renewals with these types of contracts. The entity is in substance recognizing revenue for a future contract between the entity and a customer on day one. It is not clear whether this example is consistent with the underlying principles described in paragraphs 12 – 15, which requires the identification of a contract. If either party had the option, or right to cancel, or not renew the

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contract for each subsequent year, a contract does not exist for the renewal periods, consistent with paragraph 15, and therefore revenue could not be recognized for the future renewal periods. It is also not clear why this example is different than Example 12, Scenario 2, which prohibits recognition of the revenue related to amounts that are subject to subsequent sales. We recommend clarifying the basis for the conclusion in this example.

Thank you for the opportunity to provide our comments on the Proposed Standard. Should you have any questions please contact James A. Dolinar

Cordially,

Crowe Horwath LLP

Attachment A Exposure Draft Questions

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?

We agree with the concept which provides for revenue recognition in situations where the entity transfers control of goods or services over time. However, we request the Board to consider including a practical expedient if goods or services are transferred over time and that time is relatively short in nature (for example less than one week).

There are a number of situations where performance obligations are satisfied over a short period of time, but the complexity of estimating and calculating the revenue to be recognized may be greater than the benefit received. For example, consider an automotive repair and body shop that is in the process of repairing or rebuilding automobiles. The process to repair or rebuild an automobile may take some time and this may cross a reporting period. Based on the criteria provided in paragraphs 35 and 36, if the entity was in the middle of a repair, it could be determined that another entity could fulfill the remaining obligation to the customer without having to re-perform the repair services provided to date, which would require the entity to record a portion of the revenue. Recognizing revenue as the service is performed may be easily accomplished for a few car repairs in process, but would become more complex if the entity has multiple repair locations and thousands of vehicles in process at the end of a reporting period.

We recommend the Board consider a practical expedient that would allow an entity to record revenue when the obligation is completely satisfied, rather than over time when the amount of time is relatively short, for example, less than 7 days. We understand the Board is cautious about using bright lines and concur with that concept in a principles based standard, however, in this case a bright line appears needed to prevent wide interpretation of a "short time period"; should the Board agree to provide a practical expedient. We also recommend that use of the practical expedient should be clearly disclosed in the notes to the financial statements.

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?

Paragraph 50 describes the process for determining the transaction price and specifically states "The transaction price does not include the effects of the customer's credit risk as discussed in paragraphs 68 and 69." The basis for conclusions, paragraph BC34(b) states "However, if there is significant doubt at contract inception about the collectability of consideration from the customer, that doubt may indicate that the parties are not committed to perform their respective obligations under the contract and thus the criterion in paragraph 14(b) may not be met." The basis for conclusions suggests that collectibility at inception is a criterion in determining whether you have a contract under paragraph 14(b), which is not clearly described in the ED, other than in the basis for conclusions which are not retained as part of authoritative U.S. GAAP. Based on paragraph 14(b), we believe some might conclude that credit risk may preclude consideration as a contract and therefore, preclude revenue recognition. However, the text in paragraph 50 may lead a reader to conclude that credit risk does not enter into the revenue recognition decision at inception. If the Board believes an assessment of collectability at contract inception is a key element to determining whether the parties "are committed to perform their respective obligations", we recommend it is important to reflect this concept in the final standard, rather than only in the basis for conclusions.

Further, if collectibility is a concern at inception, and therefore the criteria for a contract is not met; it is not clear what GAAP should be followed for the transaction costs as they are incurred. For example, assume collectability is a concern; however a manufacturing company, for a variety of reasons, still decides to conduct business with this customer. It is not clear how the entity would account for a contract asset until collectability is no longer a concern.

In addition to the above comments on the determination of collectibility at contract inception, it is also not clear what factors an entity must consider in determining that the other party is committed to performing their obligations under the contract. The ED does not appear to provide any criteria in order to demonstrate the customer is committed to performing under the contract. It is also not clear whether committed to performing under the same meaning as is capable of performing under the contract. Without some level of defined criteria, many entities will default to the conclusion that the customer is committed to performing its obligations under the contract, absent any known facts which would indicate otherwise. This will also create additional difficulties from an audit perspective. As such we recommend clarification of the term "committed to performing under the contract" in the final standard.

The FASB and the IASB staff recently conducted a webcast (February 29, 2012) to address frequently asked questions, which was helpful in providing clarification of the Proposed Standard. One point highlighted during the webcast was presentation of the customer credit risk line item adjacent to the revenue line in the statement of comprehensive income. The presenter also appeared to indicate that it was not intended or allowed for the customer credit risk line to be subtracted from the revenue line resulting in a caption of "net revenue". We note that ASU 2011-07 provides for this presentation, although we understand portions of this ASU are being modified as a result of the ED, including paragraph 954-605-55-1, which includes this presentation. If our understanding from the webcast is correct, we believe the ED is not clear that the presentation of a "net revenue" line is not allowed. It is not clear why the "net revenue line" presentation would be prohibited from reading the basis for conclusions. Further, if our understanding from the webcast is correct, we recommend clearly indicating the prohibition of this presentation in the requirements of the proposed standard. We also recommend including the basis for this conclusion in the final standard, though we do not believe prohibition of this presentation is warranted.

Finally, we note that the presentation requirement for customer credit risk is contained in paragraph 605-10-30-23 in the proposed amendments to the Codification. We also note that the Codification amendments include separate paragraphs for "Other Presentation Matters" beginning in paragraph 605-10-45-1. We believe it would be helpful to include all presentation matters in the same general section of the Codification and recommend moving the requirement noted above to this section.

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 reasonably 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 do you recommend and why?

We agree with the proposed constraint included in the ED.

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?

We agree with the Board's decision to limit the scope of the onerous test to performance obligations that are satisfied over time. We also agree with the practical expedient to only apply the onerous test to those performance obligations expected at inception to be satisfied over a period of time greater than one year. However, it would be helpful to specifically address when a bundle of services is considered to be a single performance obligation as described in paragraph 29. While the test is not to be performed at the contract level, many construction contracts would be viewed as a single performance obligation (paragraph 29 and IG62 Example 5). A simple change to paragraph 86, could clarify this point. The additional text is underlined below:

Paragraph 86. For a performance obligation (see paragraphs 23 - 30) that an entity satisfies over time (see paragraphs 35 and 36), and that the entity expects at contract inception to satisfy over a period of time greater than one year, an entity shall recognize a liability and a corresponding expense if the performance obligation is onerous.

Additionally, there are two other fact patterns that are common in the construction industry that are not specifically addressed within the ED. First, the scope of the test applies only to contracts expected at inception to be satisfied over a period of time greater than one year, which would be a change in current practice for the construction industry. Current guidance requires recognition of the entire anticipated loss as soon as the loss becomes evident (ASC 605-35-25 paragraphs 46 through 50). Therefore, under the ED construction contracts that expect to incur a loss and that are shorter than one year would not recognize that loss until the performance obligation has been satisfied, either over time or at completion. As such contract losses would be deferred in these situations, and could impact operating results if the contracts lapsed over reporting periods, although the losses would generally be recognized in less than 12 months. We understand the Board selected 12 months based on feedback received on the 2010 exposure draft, however, it is not clear whether the Board considered these types of loss contracts in their deliberations. We believe it would be beneficial for the Board to include their considerations of this issue within the basis for conclusions.

Another fact pattern common in the construction industry are job overruns. It is not uncommon for a contract to be extended months beyond its original target completion date, whether due to delays from other contract providers, weather or other reasons. These situations also may result in losses due to the overruns. The ED requires the onerous test to be determined "at inception" for contracts in excess of one year and does not provide for any re-assessment of that determination if the facts change, such as a 9 month contract at inception is extended to a 15 month contract. A loss determined on this delayed contract would not be recorded until the performance obligation is satisfied, which would be different than a comparable loss contract that was estimated to be 15 months at inception. Thus, the potential exists for an entity to report anticipated losses differently at an annual reporting date for similar obligations (i.e. accrued losses on contracts of anticipated longer duration). We recommend consideration of whether the proposed standard should provide for a re-assessment in the situation described above.

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 appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial statements.

The Proposed Standard requires significant qualitative and quantitative disclosures regarding an entity's revenue recognition policies, activities and the related amounts presented in its financial statements. While many of the disclosures provide decision useful information to users, certain disclosures appear overly burdensome for preparers in interim financial statements; specifically the reconciliation disclosures of: contract balances in paragraph 117, onerous performance obligations in paragraph 123, and the various items in paragraph 128. We support the accommodation for nonpublic entities which does not require these reconciliation disclosures in any financial statements.

There has been a gradual shift to increased disclosures not only in annual financial statements, but in interim financial statements as well. The interim disclosures now require many of the annual disclosures which is a change from a concept that interim financial statements should primarily disclose significant changes from the annual period. Further, as the annual disclosure requirements have increased substantially, requiring these same disclosures in each interim financial statement creates an unnecessary burden on preparers. An alternative approach to the proposed requirements in the ED would be to not require the reconciliation disclosures in interim financial statements. The Board could consider the interim disclosures as part of its post implementation review of the standard and evaluate whether those disclosures are indeed cost-beneficial on an interim basis.

We also recommend consideration of all interim disclosures on a conceptual basis rather than on a standard by standard basis. Public company filing requirements are such that it becomes more and more difficult to comply with the expanded disclosure requirements on an interim basis for each new standard. We are concerned that at some point, the interim disclosure requirements will need to be lessened or the filing due dates will need to be extended.

In addition, it is not clear whether the performance obligation disclosures required by paragraph 118 are to be presented at an aggregate level or if they are to be provided for each material performance obligation outstanding at the reporting date. Disclosing this information at an individual performance obligation level would be overly burdensome. We recommend the final standard specify the level at which this information is disclosed, which we suggest to be an aggregate level.

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 alternative do you recommend and why?

We agree the proposed revenue recognition model should be applied to other transactions that are not specifically addressed in other GAAP.