

2011-230 Comment Letter No. 98 Sanmina-SCI Corporation

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Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116
Attn: Technical Director – File Reference No. 2011-230
(via U.S. Mail and Electronic Mail)

SANMINA-SCI

Re: Comments on the FASB and IASB Revised Exposure Draft on Revenue from Contracts with Customers

Dear FASB Technical Director,

We are responding to the Financial Accounting Standards Board's ("Board") invitation to comment on the above-referenced exposure draft. We welcome the opportunity to comment on the exposure draft and appreciate the Board's decision to re-expose the proposed standard and host a series of public roundtables and discussion forums.

Overview of Sanmina-SCI and EMS Industry

Sanmina-SCI is a global provider of customized, integrated electronics manufacturing services, or EMS. Industry leading EMS companies offer end-to-end services, including product design and engineering, manufacturing, final system assembly and test, direct order fulfillment and logistics services, after-market product service and support, and global supply chain management. These end-to-end supply chain solutions encompass the entire lifecycle of a customer's product, from product design and engineering, through manufacturing, to direct order fulfillment and after-market services and support. Customers may choose to use all or some of these services. Our annual revenue for our most recently completed fiscal year was \$6.6 billion.

Background Information Regarding EMS Manufacturing Services

EMS companies manufacture products for original equipment manufacturers (OEMs) that choose not to manufacture their own products. OEMs choose to outsource manufacturing to EMS companies for a variety of reasons, including:

Reduced operating costs and capital investment

- Ability to focus on core competencies such as product design/development and marketing and sales
- Improved supply chain management and purchasing power
- Access to global manufacturing capabilities
- Accelerated time-to-market

Background Information Regarding Sanmina-SCI Manufacturing Services

Our manufacturing operations are located in 18 countries and consist of more than 50 facilities with a combined manufacturing space of approximately 12 million square feet. We manufacture over 18,000 products, consisting of complete systems or subsystems, including:

- Communications infrastructure equipment such as wireless and wireline access, filters, optical networking and transmission, enterprise networking systems, and switching, routing and transmission systems.
- Enterprise computing and storage systems.
- Multimedia products such as digital set-top boxes, point-of-sale equipment, digital home gateways, professional audio-video equipment and internet protocol entertainment devices.
- Industrial and semiconductor capital equipment, front-end environmental chambers, optical inspection and x-ray equipment, explosive detection equipment and large format printing plate machines.
- Defense and Aerospace products such as avionics systems and processors, weapons guidance systems, tactical and secure network communications systems and detection systems for homeland defense.
- Medical systems such as blood glucose meters, respiration systems, blood analyzers, ultrasound imaging systems and a variety of patient monitoring equipment.
- Automotive products such as engine control units, body controllers, radios, and HVAC control heads and blower modules.

Our manufacturing services are vertically integrated, allowing us in certain instances to build a finished product for our customer using both components manufactured by us and components purchased by us from other vendors. Components manufactured by us include:

- Printed circuit boards (PCBs)
- Backplanes (very large PCBs that serve as the backbones of sophisticated electronics products) and backplane assemblies
- Enclosure systems, which are used to house and protect complex and fragile electronic components, modules and sub-systems.
- Cable assemblies, which are used to connect modules, assemblies and subassemblies in electronic devices.
- Precision machining
- Plastics
- Optical and Radiofrequency components and modules
- Memory modules, which are integrated subsystems that use industry standard integrated circuits.

Once a customer's product is ready for volume manufacturing, we manufacture high volumes of identical units to a customer's unique specifications. The manufacturing cycle for the majority of products we manufacture is less than two weeks. Our contracts generally require the customer to provide us with a periodic forecast of their near-term production needs. Based on this forecast, we procure materials through the supply chain to ensure that sufficient materials will be available to meet our customer's specific delivery requirements. Some of the materials used in the manufacturing process are unique to a customer's product and some are common to products of many customers. Our customers are generally contractually liable for materials we purchase to support their forecast requirements. We generally do not begin manufacturing activities until we receive a firm purchase order from a customer and are entitled to payment for work performed-to-date in the event an order is cancelled.

Revenue Recognition - Current Rules vs. Proposed Rules

Currently, in accordance with ASC Topic 605, *Revenue Recognition*, we generally recognize revenue upon delivery provided all other revenue recognition criteria have been met by that time. We strongly believe this model is appropriate for, and consistently applied within, our industry and therefore do not believe a change to the timing of the recognition of our revenue is warranted or desired.

The proposed standard states that an entity shall recognize revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service to a customer. An entity is required to first determine whether the entity satisfies a performance obligation over time by transferring control of a promised good or service

over time. If an entity determines that it does not satisfy the performance obligation over time, then by default the performance obligation is satisfied at a point in time.

We appreciate the additional criteria in the revised exposure draft for determining when a performance obligation is satisfied over time, but we are very concerned that without further modification or clarification we may be required to recognize revenue over time, which we do not believe would be appropriate.

Paragraph 35(a) of the Proposed Standard states that "a vendor would be deemed to transfer control of a good or service over time if the vendor's performance creates or enhances an asset that the customer controls as the asset is created or enhanced..." Control of an asset refers to the ability to direct the use and obtain substantially all of the remaining benefits from the asset. Control includes the ability to prevent other entities from directing the use of and obtaining the benefits from an asset. The benefits of an asset are the potential cash flows that can be obtained directly or indirectly in many ways, such as by:

- Using the asset to produce goods or provide services
- Using the asset to enhance the value of other assets
- Using the asset to settle liabilities or reduce expenses
- Selling or exchanging the asset
- Pledging the asset to secure a loan
- Holding the asset

In addition, indicators of the transfer of control include:

- The entity has a present right to payment for the asset
- The customer has legal title to the asset
- The entity has transferred physical possession of the asset
- The customer has the significant risks and rewards of ownership of an asset
- The customer has accepted the asset

We believe examples in which the vendor's performance creates an asset that the customer controls would include 1) a vendor constructing a building on land owned by the customer; 2) a contract, such as one with the U.S. federal government, that transfers ownership to the customer as work progresses; 3) a contract that allows the vendor to

require the customer to make progress payments to support the customer's ownership investment and to approve progress to date if it meets the contract requirements; and 4) a contract to develop an IT system on the customer's premises.

Although we do not believe we would be deemed to transfer control over time in accordance with Paragraph 35(a), we are concerned that because of the high degree of judgment involved in making this assessment, a reasonable person could reach a different conclusion. We manufacture products on behalf of other companies (and not for ourselves) in accordance with their product specifications and pursuant to their anticipated delivery requirements. Our customers provide us their forecasted delivery requirements and we manage the supply chain in order to ensure sufficient materials are available to meet such requirements. Often times, customer-specific materials are purchased from vendors specified by our customer and with whom our customer has directly negotiated a price. Upon receipt of a firm purchase order from a customer, we begin our manufacturing activities with the objective of delivering the specified number of units by or on the customer's requested delivery date. In addition, we:

- 1) Can allocate common materials between customers at our discretion, even after manufacturing has begun
- 2) Do not have a present unconditional right to payment until delivery of the product
- 3) Retain legal title to and physical possession of the materials/product until delivery to the customer
- 4) Can use materials, including customer-specific materials, and work-in-process as collateral for borrowing purposes and
- 5) Have significant risks and rewards of ownership of the materials/product until delivery to the customer.

Based on the above, with particular emphasis on the fact that our manufacturing cycle times are generally less than two weeks and that title, physical possession and risk of loss do not transfer to the customer until delivery, we do not believe our customers control assets as they are being manufactured. However, as indicated previously, this assessment involves a high degree of judgment.

If an entity concludes that a customer does not control an asset while the asset is being created or if it is not clear whether the customer controls an asset while the asset is being created, the criterion in Paragraph 35(b) must then be applied. Paragraphs 35(b) and 35(b)(iii) indicate that a performance obligation is satisfied over time if the vendor's performance does not create an asset with an alternative use to the vendor and the vendor has a right to payment for performance to date and is expected to fulfill the contract as promised. We believe this guidance is relevant to services for which vendors are compensated based on time incurred rather than on an outcome or deliverable (e.g., legal

services, architectural design services, consulting services, etc.) and to situations such as the development and sale of residential real estate (e.g., individual apartment units).

A strict interpretation of Paragraphs 35(b) and 35(b)(iii) could lead to the conclusion that our performance obligations are satisfied over time. For example, at some point during the manufacturing cycle, an asset will no longer have an alternative use to us either because it includes customer-specific materials or has been configured to a customer's unique specifications. The point during the manufacturing cycle at which this occurs will vary based on the product being manufactured. Additionally, purchase orders placed by our customers generally require payment for work performed to date (including a reasonable profit margin) in the event of order cancellation. Based on this, the criteria in Paragraphs 35(b) and 35(b)(iii) appear to be met, thus indicating that revenue should be recognized over time.

We strongly believe that a change from a delivery-based model to a model that requires recognition of revenue throughout the manufacturing process would be an unintended and inappropriate consequence for our industry. The implementation guidance and basis for conclusions in the proposed standard refer exclusively to assets requiring lengthy production times (e.g., ships, residential real estate, buildings requiring 2-years for construction, etc.) and to services which are consumed as provided. We agree that recognizing revenue over time may be appropriate in these situations, but do not believe it would be appropriate for our industry for the following reasons:

- Our manufacturing operations produce a high volume of identical units in a short period of time (our manufacturing cycle times are generally less than 2 weeks).
- Our customers contract with us to deliver finished product to them on specified dates. Our ability to meet our customers' delivery schedules is a key factor in our success. Recognizing revenue prior to delivery of a finished product (contracted obligation) would be counterintuitive and difficult for users of financial statements to understand, especially considering that a partially completed product has no utility to our customers and that our customers do not recognize an asset on their books until we have delivered a finished product to them.
- Delivery is the point at which our customer takes title to the product, assumes significant risks and rewards of ownership of the product, and incurs an unconditional obligation to pay for the product. We own the asset (work-in-process) throughout the manufacturing cycle and all consideration from our customer is due after delivery. We do not receive "up-front", "progress" or "advance" payments from our customers. As such, the value we transfer to our customer in the form of delivery of a finished product is aligned with the amount of consideration to which we have a right to invoice.

- Delivery is an objective, measurable and verifiable (auditable) criteria, thus reducing the risk of fraud, manipulation and error. Recognizing revenue throughout the manufacturing process would be highly complex and involve a high degree of subjectivity that would lead to increased risk of fraud / error, as well as increased costs to audit.
- Comparability of financial results within the industry would be significantly impaired due to the use of different methods to measure progress towards completion of a performance obligation.

Additionally, the costs associated with a change in our revenue recognition model would be significant. We manufacture over 18,000 products at over 50 locations and our systems, processes and controls are currently designed to support a revenue recognition model based on delivery, which is objective and measurable and coincides with our billing activities and the timing of liability recognition by our customers. The complexity associated with recognizing revenue throughout the manufacturing cycle would require substantial reconfiguration of our systems, reengineering of our business processes, and the design and implementation of new internal controls. Additionally, due to the inherent subjectivity that would be involved in the revenue recognition process, we would incur a significant amount of incremental costs on an ongoing basis for accounting personnel and external audit fees.

What Are We Asking For?

At a minimum, we believe there should be a practical expedient for measuring progress towards completion of a performance obligation for short duration contracts that allows companies to recognize revenue using an output method such as units of production or units of delivery. Specifically, we believe an output measure using units of production or delivery would be appropriate in situations in which a high volume of identical units are being produced / delivered using a manufacturing process that has a short cycle time.

Summary

In summary, we appreciate the Board's consideration of the concerns expressed regarding the initial exposure draft and are pleased with the decision to re-expose the proposed standard. However, we are concerned that the objective of creating a single, comprehensive standard for revenue recognition may result in an unintended consequence for companies in the contract manufacturing business. We encourage the Board to consider the specifics of our industry and to modify the final standard in such a way that allows us to continue to recognize revenue in a manner that reflects the economic substance of our transactions and provides the most useful information to users of our financial statements.

Sincerely,

Todd Schull

Corporate Controller and Chief Accounting Officer

Cc: Prabhakar Kalavacherla