



April 30, 2012

Ms. Susan M. Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 2011-230

Dear Ms. Cospers:

Connor Group LLC is pleased to provide our comments on the Proposed Accounting Standards Update (ASU), *Revenue Recognition (Topic 605), Revenue from Contracts with Customers, Revision of Exposure Draft Issued June 24, 2010* (the Exposure Draft as issued on November 14, 2011 and January 4, 2012). Connor Group was founded in 2005 and is a technical accounting advisory firm built of Big 4 alumni and industry executives. We currently have over 200 clients in North America, Europe, Asia, Australia and South America. We specialize in helping our clients solve complex technical accounting issues under both US GAAP and IFRS, with revenue recognition being a heavy focus area. Our clients represent industries, among others, such as technology, software, Internet, cloud services, life sciences, and manufacturing.

We commend the efforts of the Financial Accounting Standards Board (FASB or the Board) and the International Accounting Standards Board to develop a comprehensive framework for recognition of revenue. At the same time, we believe the Exposure Draft requires substantial additional work to evolve into an accounting standard that can practically be used by companies and auditors. We recommend another round of exposure after feedback from respondents has been reflected in the current draft.

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We have included in this letter our responses to each of the “Questions for Respondents” posed in the Exposure Draft. We also have provided additional points for the Board’s consideration.

Comments on Questions for Respondents

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?*

Response 1. We support the FASB proposal on this matter.

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?*

Response 2. We do not support the proposal in the Exposure Draft. In certain instances the amounts resulting from credit risk and disclosed in a separate line item may be material to an entity, and we believe this information would be important to disclose either on the face of the statement of comprehensive income or through a footnote disclosure. However, for most entities bad debt expense is insignificant compared to other risks associated with recognition of revenue (such as customers’ rights of returns, refunds, rebates and allowances, etc.) Therefore, we believe that the proposed presentation may not appropriately reflect the level of exposure to various risks associated with revenue recognition. Our recommendation is to continue to recognize the impact of the initial collectability assessment through changes in revenue, and subsequent allowance for uncollectible balances through bad debt expense. We also believe the Exposure Draft should provide for collectability assessment on a portfolio of contracts in line with guidance in paragraph 6, as the current revenue recognition guidance often is interpreted to result in tedious and cost-ineffective collectability assessments for even individually small contracts.

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?

Response 3. We support the introduction of a uniform threshold required to recognize revenue (*"the amount to which the entity is reasonably assured to be entitled"*). At the same time, we do not believe the criteria required to assert that the entity is reasonably assured to be entitled to revenue have been drawn at the right level. We suggest a better balance could be achieved between the threshold and the risk associated with recognition of revenue to both the users of the financial statements and to the entity. For example, we believe experience with similar types of performance obligations that is predictive of the future raises the bar unnecessarily high in limiting the amount of revenue to be recognized. We believe such experience is just one of the ways an entity could reach the conclusion that the revenue amount is reasonably assured. As an alternative, the analysis of facts and circumstances applicable to a revenue arrangement could indicate that the amount of revenue is reasonably assured even in the absence of comparable historical experience. For example, if an entity can assess that any events that could potentially reduce the amount of revenue are highly unlikely to occur, or highly unlikely to impact materially the financial statements, based on observable prior lack of occurrences of such events, we believe it should be possible for the entity to recognize revenue based on the assumption that such events will not occur. Note that under this recommended approach, an entity may not have had any experience with similar performance obligations in the past or may have structured a unique transaction with the customer. However, the entity has structured the transaction price to depend on events that it has observed occurring in the past, or has a high level of confidence will or will not occur in the future. This assessment could be done on either individual contract or portfolio of contracts basis, in line with approaches in paragraph 6.

Conversely, we believe reliance on historical experience in certain situations can raise the risk associated with recognition of revenue too high. The issue is that the Exposure Draft does not define what level of comfort an entity should possess when assessing its historical experience for being predictive of the future. For example, paragraph IG71 includes Example 14 where an entity estimates and recognizes revenues based on predictions of consumer behavior over multiple years in the future. We would be highly skeptical of an entity's ability to make such predictions in practice. We estimate that most of our clients would not be willing to represent that historical experience is predictive of the future over such extended periods. However, we can also see how some entities may be willing to take on additional risk for themselves and for the uninformed investors, and we do not believe such risk, if material to the financial statements, would be justified. As an alternative, we would suggest consideration of whether the future events that could result in reduction of revenue amounts are highly



unlikely to occur or highly unlikely to have a material impact on the financial statements. With this threshold, we do not believe an entity could make a call that an individual consumer will extend the insurance policy for 4 years, if this is a material estimate to the entity.

Further, we believe that the threshold for recognition of revenue should be applied consistently in all circumstances.

The same Example 14, along with paragraph 85, illustrates one undesirable inconsistency. While we support the approach in paragraph 85 that prohibits recognition of royalty amounts from licensing of intellectual property, it is not clear to us what conceptually puts intellectual property arrangements into a different playing field from any other arrangements. Further, intellectual property arrangements often contain provisions for milestones that could be driven by results of research and development, and thus would not fall into the scope of paragraph 85. Thus, an entity could draw from historical experience that, for example, 65% of drug candidates in phase I clinical trials succeed in progressing to phase II, and recognize 65% of the milestone amount due to it from the licensee customer upon such success. With the milestone amounts often being very material to the financial statements of the entity, we believe such approach raises the financial statement risk too high.

Another example can be found in paragraph 57 as compared to paragraph 81 and IG2 through IG9. The threshold for recognition of revenue where customers can require a refund is based on the amount that the entity reasonably expects to refund to the customer. There is no guidance regarding how this amount could be determined. This approach varies from the general principle of recognizing revenue based on the amount reasonably assured to be entitled to. We do not believe this difference in approaches is justifiable. Also, we believe discussion of return refund liability in paragraphs IG 2 through IG9 should be expanded to cover non-return refunds, rebates and other similar adjustments to revenues.

Yet another example of inconsistency is paragraph 47 that discusses uncertainty in measuring progress towards completion of obligations satisfied over time. Under this paragraph, the entity's revenue would be constrained by the lack of reliable information to apply an appropriate method of measuring progress. It is not clear to us as to how the criterion of lack of reliable information correlates to the "reasonably assured" criterion (i.e. whether it is a higher or a lower threshold). We also note that these two criteria address different aspects of revenue (measurement of progress for a deliverable v. whether the fees for delivered elements are, in present day terms, fixed or determinable). However, ultimately both of these criteria determine or affect the amount of revenue to be recognized. Thus, we recommend to set the threshold for these criteria at the same level.



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?*

Response 4. We do not support the proposed approach. We do not see why an obligation extending beyond one year should be treated differently than one that is shorter than one year. For example, depending on when it starts, a six month onerous obligation has a 50% likelihood of impacting accounting for multiple fiscal years. Further, in many instances entities willingly enter into onerous performance obligations for strategic reasons, e.g. buy into new markets, obtain a marquee customer, etc. In those instances, it would appear that the impact of the decision to invest into a strategic relationship or transaction is more appropriately recognized over time, similar to how, for example, an entity would recognize the impact of an advertising contract over time when it consumes the services, and not when it enters into an advertising contract before any services have been consumed. Arguably, if the benefits of advertising services are highly uncertain, one could argue that the contract should be treated as onerous and the expense should be recognized on signing of the contract.

We recommend that losses from onerous contracts be recognized in the following circumstances: (i) when an asset has been impaired (including inventories not realizable above cost); (ii) when a contract becomes onerous subsequent to inception as a result of changes in applicable facts and circumstances. In particular, in line with the existing guidance, we recommend to add to the Exposure Draft that if an entity has completed its performance obligations under a customer agreement, but has not yet incurred all applicable costs, such remaining costs should be accrued by the time the performance obligations have been completed.

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.

Response 5. We believe many of these proposed disclosures are important and would not result in excessive burden on companies. Specifically, we would find it useful to obtain information about disaggregation of revenue (provided judgment is applied to determine which facets of data are relevant and material to financial statement users), reconciliation of contract assets and liabilities and costs to obtain and fulfill contracts, and an analysis of performance obligations. As noted above, we do not believe the current onerous contracts model is completely appropriate, however, we would support disclosures of material onerous contract information if the model is modified.

We also recommend adding to the list of required disclosures a discussion of significant risks that could impact the amounts of revenue recognized with respect to the past transactions.

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?*

Response 6. We agree with the Board proposal. We also recommend adopting similar approaches to other non-revenue transactions that result in gains for the entity, e.g. recognition and allocation of gains from favorable litigation settlements. This would expressly allow accountants to use the proposed guidance to account for multiple element arrangements with both revenue and non-revenue elements.

Other Recommendations and Suggestions

Combination of contracts (paragraphs 16-17)

We note that under paragraph 17, two contracts negotiated as a package but that have different commercial objectives will not be combined into a single arrangement. We question whether that was the FASB intention to provide for this. For example, if two



parties negotiate concurrently and execute two contracts on the same day, one for licensing of intellectual property, and the other for delivery of unrelated services, the Exposure Draft would appear to allow to account for these contracts as distinct performance obligations, even if the negotiated prices of the two deliverables have been impacted by concurrent negotiation.

Contract modifications (paragraphs 18-22)

We noted that paragraph 21 defines when a contract modification may represent a new contract. We recommend to supplement these criteria to provide that a new contract does not change significantly any of the existing deliverables or related prices. Otherwise, a modification that both adds new deliverables and eliminates or modifies the existing deliverables would appear to fall into the scope of paragraph 21 and be accounted for as a new contract and not a modification. We are not certain if this was the FASB intention.

Nature of Obligations (paragraph 24)

We believe the FASB should provide additional guidance regarding what would constitute an implied obligation and how to measure its term. In certain circumstances, the question is straight-forward, e.g. a software company provides six months free courtesy support to customers who have not purchased a support contract. In other instances, the issue is more difficult. For example, a virtual world company provides an implied lifetime obligation to maintain for free access to virtual goods that had been licensed by the customer. However, in return the company expects (but does not require) each user to pay voluntarily a monthly amount to license additional virtual goods. Absent customer response and ongoing payments, the company can discontinue the virtual world at any time without refund. Is there an implied obligation that requires revenue allocation.

We also believe FASB should provide guidance regarding which obligations could be considered, in today's terms, inconsequential and perfunctory, to enable practicalities in accounting. For example, a cloud services company provides a lifetime obligation to maintain for free data that had been entered by the customer during the contract period that has ended (but the customer cannot enter or process any additional data). Is there an argument that such obligation does not require revenue allocation, if the extent of time and other effort required to satisfy it is de minimis.

Separate performance obligations (paragraphs 23-30)

We question how effective is the guidance in paragraph 28 regarding identification of distinct performance obligations. While with the adoption of ASU 2009-13 many entities have concluded that upfront services previously normally deferred and recognized over the contract term do have standalone value and thus should be recognized at the outset



of the arrangement, one example that currently continues to require deferral and amortization is upfront setup or activation fees, for example, a fee due to a health club upon enrollment. However, it appears that under paragraph 28(b) the health club will be able to account for this fee as a distinct performance obligation as well, since the consumer can benefit from the sign-up service together with other resources (such as ability to attend the club that is sold separately e.g. on renewal basis) and that is readily available to him/her. Further, neither of the conditions in paragraph 29 will apply to the sign-up service. We do note guidance in both paragraphs 25 and IG29 through IG32 that deals with fees for setup and similar services. However, we do question whether the criteria in paragraph 28 have been effectively designed if the bar is set so low that even set up fees would qualify absent clarification elsewhere in the Exposure Draft. In this regard, we also notice language in paragraph 36 that says, “For example, if an entity grants a license that is not distinct because the customer cannot benefit from the license without an additional service that the entity promises to provide, the entity should account for the combined license and service as a single performance obligation satisfied over time.” However, this language appears to contradict the criteria in paragraph 28, under which such license will be distinct, under criterion (b), because “the customer can benefit from [it]... together with other resources readily available to the customer ... [that include] goods or services that are sold separately (by the entity or by another entity)...”. Since the entity most likely sells the service separately, it would be a readily available resource that would allow the customer to benefit from the license.

Similarly, we believe the criteria in paragraph 29 are not totally effectively designed. For example, an entity that sells equipment could arguably ship to the customer equipment parts and components as they become available instead of the assembled equipment units and recognize revenue on such shipments if no significant modification or customization of parts and components is required (e.g. if only simple assembly is required). We are not clear if it was the FASB intention to allow recognition of revenue in these circumstances. Note that the parts and components will also meet distinct performance obligation criterion (b) in paragraph 28.

Methods of measuring progress for obligations satisfied over period of time (paragraphs 41-48)

In certain industries such as cloud services, entities may earn service revenue, for example, in the form of a fixed monthly fee and a variable fee based on specific transactions processed during a month. As we understand the Exposure Draft, it would require to estimate from time to time the total transaction price to be received under the term of the contract, and recognize the amounts based on an output (e.g. number of transactions processed) or an input measure, subject to the constraint of the entity being reasonably assured to be entitled to the amounts recognized. In our mind, applying this framework may result in a revenue recognition pattern that is not indicative of the entity’s performance. We believe when the negotiated contractual terms of the arrangement provide for multiple bases on which fees for services are



earned, it is appropriate to use multiple measures of progress towards completion in recognizing revenues in the arrangement. Thus, in the example above we believe it could be appropriate for the entity to recognize the monthly fee component on a straight-line basis while recognizing the fee based on the number of transactions as those transactions are processed, even if the volume of such transactions to be processed in future periods under the contract could be less than in the current month (e.g. due to seasonality). We believe using multiple bases for measuring progress in these situations is a better reflection of the pattern of an entity's performance than applying a single either input- or output-based measure.

Also, it is unclear how paragraph 42 interacts with the allocation of multiple deliverables guidance in paragraphs 70-80. We can put forward arguments that paragraph 42 is applied before paragraphs 70-80 (thus effectively overriding the RSSPM), or alternatively that paragraph 42 is applied after paragraphs 70-80 (in which case the amounts recognized in revenue under paragraph 42 would be based on RSSPM). A clarification to this effect would be helpful.

Time value of money (paragraphs 58-62)

We believe the Exposure Draft should clarify that the use of the time value of money calculations is limited to those circumstances when the transaction price has been affected by primarily passage of time between the time of delivery and the time of payment, as opposed to uncertainty associated with the value of an element. As an example, an entity may have delivered a license to a customer and was paid an amount up front, and may be entitled to an additional milestone payment in 5 years depending on performance of the licensed product. It is uncertain at the inception of the arrangement whether such milestone will be received. Should the entity have negotiated to be paid in cash for all amounts due at the inception of the arrangement, it is likely that the amount received would have been significantly discounted primarily as a reflection of this uncertainty, as opposed to the time value of money. In our mind, in these circumstances entities should not account for the time value of money element, as the delay in payment is primarily due to the significant uncertainty about the value of the license deliverable, as opposed to the passage of time (financing element).

Consideration payable to a customer (paragraphs 65-67)

We noted that paragraph 66 indicates that "if the entity cannot reasonably estimate the fair value of the good or service received from the customer", the entity should recognize the entire amount paid for the good or service as reduction in revenue. We are struggling to think when there could be circumstances that the entity would not be able to reasonably estimate the fair value of a purchased good or service. We believe that if it is acceptable to use estimated selling prices for purposes of allocating and recognizing revenues, and require such estimates to be made in all circumstances, it should be also acceptable to use estimates of fair value for any items purchased by the



entity. Also, in these days when entities habitually use appraisers for many fair value estimates, we believe in most if not all instances an appraiser would be able to do a fair value estimate of a good or service for the entity. It is not clear to us what level of comfort or precision would be required to assert that an entity can or cannot “reasonably estimate” the fair value. For example, if a very subjective Level 3 model (under ASC 820) has been used to determine the fair value of a product or service, does this represent a “reasonable estimate” of fair value? Or if the estimate was based on methodologies similar to those used to determine standalone selling prices, is this a “reasonable estimate”?

Use of Relative Standalone Selling Price Method (paragraphs 70-80 and IG69)

We do not believe the relative standalone selling price method (RSSPM) should be the only method allowed to allocate transaction price among multiple performance obligations. While conceptually acceptable, RSSPM has significant practical drawbacks. It is extremely difficult and costly to automate; it adversely impacts the entities’ ability to forecast and assess their performance; its mechanics are not well understood by those who are not skilled with quick calculations. Further, it often does not result in meaningful differences compared to other methods, and we do not believe its use is preferable from either pure mathematical, economic, business, or conceptual accounting perspective. Our observations are based on our experiences of the last few years, as we have helped dozens of clients adopt ASU 2009-13 and 2009-14. In many instances, the cost to a company to adopt ASU 2009-13 significantly exceeded the impact of the adoption on revenues. One of the underlying reasons is that there are very few accounting software applications that support the relative selling price method. Specifically, none of the major vendors of ERP systems have built-in functionality for this method or for estimates and assumptions regarding estimated selling prices required to implement it. If implemented in Excel, this method is not scalable for entities with a large volume of transactions, and the complexity of the mechanics of the calculations is extremely prone to errors. One could argue that when adoption was not expected to result in material differences, shortcuts and other methods could be used. However, in practice we have observed that intuitive shortcuts could not be designed in most instances due to the complexity of this method. The relative selling price method also made it considerably harder for companies to prepare accurate revenue forecasts and to evaluate their progress during a period towards meeting their revenue targets, and for sales personnel to estimate revenue and commissions from a sale.

We believe the standard should allow companies a choice of an allocation method that reflects the economic substance of customer arrangements and that is consistently applied to all similar transactions. In particular, we believe the residual method should also be allowed as a practical alternative in all circumstances. We do not believe variance in practice between companies will impact the investors’ analysis of



performance of these companies, as we do not anticipate there to be significant differences in results of operations from the choice of an allocation method.

We also believe the requirements in paragraph 75 to allocate discount to one or a few elements are needlessly too rigid if RSSPM remains the only allowed allocation method in most circumstances. There are numerous circumstances outside of those listed in this paragraph when it could be relatively easy for both the entity and its auditors to reasonably establish that the discount relates to one element in the arrangement. We recommend leaving entities with more discretion regarding the allocation of the discount.

We believe the intent and provisions of paragraph 76 regarding allocation of contingent consideration are also not clearly or properly laid out. On one hand, any undelivered element with separate billing results in contingent revenue that relates specifically to the performance of the entity related to this element. Thus, if an argument could be made regarding meeting the provisions of criterion (b) in this paragraph, paragraph 76 could be used in many instances to negate the use of RSSPM in what seems to be unintended circumstances. On the other hand, looking at the illustration of using paragraph 76 guidance in Example 12 in paragraph IG69, we find the scenario described unrealistic and the accounting outcome inappropriate. We find it a reasonable argument to make that when the price of a license (e.g. license B in Example 12) is determined as royalty based on the number of units sold that is usually not predictable with any degree of certainty, the price stated for such license can be presumed to be a standalone selling price for this license. This is because should the parties to the contract hypothetically agree to reach an agreement to artificially decrease the guaranteed price of license A and artificially increase the variable price of license B, both parties are at risk of losing their bargain should there be too few or too many sales of units of product that embeds license B. In our experience, neither entity is willing to take those risks unless financial statement amounts are inconsequential. We believe in those situations an argument can be made in all practical situations that the royalty rate applicable to the variable license B, as well as the price applicable to the fixed amount license A, represent standalone selling prices for this transaction, thus requiring no re-allocation. We believe similar arguments can also be made in many situations involving delivery of products and services with the volume that is unknown and cannot be predicted at the time of entering into the arrangement, to avoid re-allocating any amounts to or from such products or services.

It is also worthwhile noting that when adopting ASU 2009-13, most entities have used an estimation approach to determine estimated selling prices (ESP). Thus, an entity may have concluded that its ESP is 70% of list price of the item based on the average selling prices or based on sales department pricing targets. However, in any individual transaction multiple factors can lead to the actual price deviating from ESP, and such deviations can be significant. While it can be often explained why the actual selling price for a specific transaction (e.g. 50% of list) differs from ESP, and if evaluated individually,



you could possibly make an argument that the actual selling price represents ESP for this specific transaction, high volume and scalability considerations often lead an entity to conclude that the price for this specific transaction is a pricing deviation, and the relative selling price method is applied to re-allocate consideration based on the perceived “incorrect” pricing of this element. Our concern is that most entities, especially those with high volumes of sales transactions, will apply the same practices under the paragraph 76 guidance, thus resulting in unnecessary re-allocations of revenue among deliverables. The impact of such re-allocations in circumstances of variable volume of royalty-generating shipments as in Example 12 can lead to what we would see as unreasonable outcomes from the perspective of revenue recognition.

Further, paragraphs 78 and 79 require that whenever the total transaction price changes (e.g. on resolution of contingencies), an entity would be required to re-run the RSSPM calculation for the change in price using the same basis of allocation as was used initially, unless restrictive criteria in paragraph 76 (discussed above) have been met. In our mind, these provisions should be amended for a number of reasons. First, practically updating transaction price and re-running RSSPM for prior period transactions will represent a very significant increase in the effort required to close the books for many high-volume entities. Second, in many instances it would be very easy to tell which specific element caused the transaction price to change. Thus, we believe a better approach – both conceptually and practically – would be to allocate the entire change in the transaction price to this specific element. Lastly, we believe that not applying the RSSPM in those circumstances will actually improve the quality of financial reporting in many instances. Consider a situation in which the entity has previously provided a service to a customer and has since shut down or disposed of the service department. Subsequently, in connection with delivery of a product to the same customer under the same arrangement, the entity concludes that there has been a change in transaction price such that RSSPM needs to be re-run for the arrangement. We would find it very odd for the entity’s financials or MD&A to say that the company has recognized service revenue when it has no service department available. We do not see the value to either the entity or the investors of following this approach.

The Exposure Draft also contains language that could be seen as contradictory. For example, paragraph 74 discusses the use of the RSSPM to allocate the discount in most circumstances, with exceptions as noted in paragraphs 75 and 76. However, paragraph 71 requires that the RSSPM be used to allocate transaction price (i.e. effectively either discount or premium) in all circumstances, providing no exceptions. And finally, paragraph 70 requires that the allocation to individual deliverables be based on amounts that depict “the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation”. To us, this last methodology annuls the use of the RSSPM and requires allocation based on contractually stated amounts that the entity earns for delivery of each product and service.



Standalone Selling Prices (paragraphs 72-73)

While it is true that selling prices in separate sales of a product or service in many instances provide the best evidence of standalone selling price, we do not believe this to be the case in all circumstances. For example, an entity may have just made the decision to transition to a different pricing, and thus historical separate selling prices are no longer relevant. Under the Exposure Draft, the entity may be required to continue using these historical separate sales prices until a significant period of time has elapsed after the transition to the new pricing. We recommend to allow entities to use more judgment to determine standalone selling prices either based on pricing in historical separate sales transactions or based on estimates.

Warranties and refunds (paragraph IG9)

We believe the scope of paragraph IG9 could also be expanded to include cash refunds in addition to product exchanges provided to customers who return defective products. As the underlying triggering obligation is defective product with a warranty, we believe the fact that a cash refund is provided, often as a result of the vendor being unable to fix the defect, should not result in different accounting from when a product exchange occurs.

Notwithstanding, we believe the Exposure Draft should also include a provision that if an entity is unable to estimate costs of providing warranty, or if the failure rates indicate that it is likely that products will be returned, revenue should not be recognized. In setting this provision, we again recommend to use the same threshold for recognizing revenue based on events that are highly unlikely to occur or highly unlikely to have a material impact on the financial statements.

Transition provisions (paragraphs 131-134)

We recommend to consider alternatives of allowing the adoption of the new guidance on a prospective basis for new or modified contracts only (similar to ASU 2009-13), on a prospective basis for all contracts with performance obligations delivered in the period of adoption and thereafter, or with adoption retrospective to the one year immediately preceding the year of adoption. Instead, we recommend more substantive disclosures about the impact of the adoption (similar to and more robust than was required under ASU 2009-13). We believe with the massive change that many companies will have to undertake, there is limited value in presenting historical information on a completely comparable basis and such value is not commensurate with the extremely significant level of effort that would be required for such entities to evaluate revenues for multiple years in the past. Further, we believe even with the expedients listed in paragraph 133, significant judgment required to adopt the new guidance retrospectively will likely lead to different conclusions than the same judgment applied in real time to current and



future transactions. Thus, we do not believe it would be feasible to accomplish the goal of presenting truly comparable historical financial statements.

Business combinations

The issue of measurement of revenues generated by the acquired entity subsequent to the acquisition is not fully addressed by the existing literature. Such literature is limited to guidance regarding determination of fair value of deferred revenue obligations assumed in the acquisition. As a result, there is diversity in practice. Consider a transaction where the acquiree delivered a product or completed a service prior to the acquisition, but was unable to recognize revenue as a result of remaining contingencies (e.g. right of acceptance, right of refund, revenue in the form of milestone or royalty with no associated performance obligations, etc.). Note that all of these amounts are not part of deferred revenue balances. Should the acquirer recognize revenue from the arrangement subsequent to the acquisition when the contingencies are resolved (e.g. the product is accepted, the right of refund expires, the milestone is received), along with an associated customer relationship intangible in acquisition accounting, or should the acquirer simply record a receivable in acquisition accounting because no performance is required?

Consider a situation where a customer has prepaid the acquiree for future shipment of goods. Should the customer deposit be reflected in acquisition accounting in a manner similar to deferred revenue (usually with a reduction in carrying value), or its face value can be presumed to approximate fair value, similar to accounts payable and accruals?

With the new revenue guidance requiring recording of contract assets and contract liabilities, how should an entity bring in acquisition accounting the value of the contract assets and contract liabilities carried by the acquiree?

If an entity acquires another company that has not yet adopted the provisions of the new revenue recognition guidance (e.g. due to different fiscal years), should it apply this guidance to the customer contracts assumed from the acquiree?

We understand that these and other questions related to interaction between revenue recognition and business combination guidance may fit into the scope of ASC 805 more than into ASC 605. However, we considered it useful to bring these matters to the FASB attention in connection with the evolving revenue recognition guidance.



We would be pleased to respond to any questions the FASB or its staff may have concerning our comments. Please direct any questions to Aleks Zabreyko (408-409-3422, aleks.zabreyko@connorgp.com) or Jeff Pickett (408-569-2291, jeff@connorgp.com).

Sincerely,

Connor Group LLC

Connor Group LLC