June 18, 2009

Mr. Russell Golden  
**Technical Director**  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116  
Sent by email to director@fasb.org

**Re:** File Reference No. 1660-100, Discussion Paper: *Preliminary Views on Revenue Recognition in Contracts with Customers*

Dear Mr. Golden:

Thank you for the opportunity to provide comments on the Discussion Paper: *Preliminary Views on Revenue Recognition in Contracts with Customers*, issued by the Financial Accounting Standards Board and the International Accounting Standards Board (together, the “Boards”). We recognize the need and greatly appreciate the Boards’ efforts to develop a simplified, consistent, principles-based standard for revenue recognition in contracts with customers, and we certainly appreciate the complexity and enormity of the project.

In general, we are in agreement with the basic principles set out in the Discussion Paper; however, there are certain specific applications of the proposed model described in the *Preliminary Views* document with which we either disagree or believe require further clarification. Overall, we believe the Boards need to provide a more robust framework around the definition of performance obligations. Accounting for standard warranties and rights of return as separate performance obligations, while potentially conceptually pure, does not represent the underlying economics of the transaction. We believe the contractual promise embodied in the arrangement is a functioning product. Therefore, a standard warranty does not provide an additional asset beyond the delivered asset. We also believe a return represents a failed sale. Therefore, accounting for a general right of return as a performance obligation could result in the overstatement of revenue and would potentially be subject to manipulation. We also believe the model would benefit from the use of more substantive examples.

In response to the specific questions raised in the Discussion Paper, we offer comments on seven matters:

- definition of a contract (Question 3);
- definition of a performance obligation (Question 4);
- identifying performance obligations - returns (Question 6);
- identifying performance obligations - sales incentives (Question 7);
- satisfying a performance obligation (Question 8);
Attachment A - Comments on Specific Questions

Question 3

Do you agree with the Boards’ definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

The Boards have defined a contract as “an agreement between two parties that creates enforceable obligations.” We generally agree with the Boards’ definition of a contract if it is another way of articulating “persuasive evidence of an arrangement” as described in SAB 104. In general, we believe existing U.S. GAAP related to the issues of combining related contracts, accounting for contract cancellation options, and gross versus net revenue accounting is consistent with the conceptual model defined in the Preliminary Views document. We believe the Exposure Draft should contain specific mention of these items. Otherwise, it is difficult for preparers to assess the full impact of the contract-based approach.

Question 4

Do you think the Boards’ proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

The Boards have defined a performance obligation as “a promise in a contract with a customer to transfer an asset (such as a good or a service) to that customer.” We generally agree with the Boards’ definition of a performance obligation but believe this area requires further clarification. We recommend providing a list of indicators to help entities consistently identify the separate obligations of a contract. For example, we believe it is unnecessary to identify contract promises at a level lower than the level at which the customer derives significant value, and we believe this view is consistent with the allocation guidance contained within this model. We support the Boards’ proposal to allocate the transaction price to performance obligations on the basis of stand-alone selling prices, or estimated stand-alone selling prices. To have stand-alone selling prices, performance obligations must have stand-alone value from the customer’s perspective. Therefore, we recommend the Boards enhance the definition of a performance obligation to include the concept of stand-alone value from the customer’s perspective. In addition, we believe the Boards should indicate that inconsequential and/or perfunctory obligations of a vendor need not have any impact on revenue accounting.

While we understand the need to identify each significant performance obligation in a contract with a customer, we recommend the Boards add guidance for aggregating performance obligations for accounting purposes. Disaggregating stand-ready performance obligations, such as post-contract support (“PCS”), into the multiple
promises of when-and-if available software updates, bug fixes, and phone support does not provide decision-useful information. We believe viewing the promises as a single, stand-ready performance obligation simplifies the accounting and would more closely reflect the economics underlying the transaction with the customer.

We do not agree with the identification of standard warranties as a separate performance obligation. A standard warranty that is provided at no additional charge on all sales and in accordance with either industry standards or statutory requirements is a fundamentally different obligation than an extended warranty or other types of PCS. A standard warranty is a guarantee that the transferred asset will function as promised, and typically covers a reasonable time period expected by customers. In our view, the contractual promise embodied in the arrangement is a functioning product. In that regard, a standard warranty is not separable from the delivered product and therefore does not provide the customer with an additional asset beyond the delivered asset. From the customer’s perspective, the standard warranty does not have stand-alone value because the customer expects to receive a functioning product. Therefore, even if the standard warranty were deemed a performance obligation, we believe the stand-alone value of the standard warranty would be $0 for purposes of allocating the transaction price. We believe standard warranties should remain within the scope of SFAS 5, Accounting for Contingencies. If the costs of honoring standard warranties is probable and can be reliably estimated, the costs should be accrued to cost of sales when revenue is recognized.

On the other hand, extended warranties and PCS are obligations for which the customer either pays a separate fee and/or receives services above and beyond the standard warranty or above and beyond diagnosis and correction of product defects. We agree that extended warranties and PCS should be considered performance obligations to which some portion of the total arrangement consideration should be allocated.

**Question 6**

*Do you think that an entity’s obligation to accept a returned good and refund the customer’s consideration is a performance obligation? Why or why not?*

We do not believe an entity’s obligation to accept a returned good and refund the customer’s obligation is a performance obligation. We believe a return represents a failed sale. The return eliminates the original sale transaction as entities are not in the business of refunding money for returns.

Under the failed sale approach, we believe an entity should be able to recognize revenue for the proportion of transactions the entity expects not to fail on the basis the customer has accepted the terms of the contract and has chosen to accept control of the good even though a general right of return still exists. To recognize revenue before a general right of return expires, an entity should have the ability to reliably estimate the proportion of sales that is likely to fail. We believe the guidance in SFAS 48, Revenue Recognition When Right of Return Exists, is appropriate and should continue to be applied or incorporated
into the proposed new standard.

We acknowledge the Boards’ concern over an entity continuing to recognize inventory when control of that inventory has transferred to a customer. However, we believe this concern can be addressed through the establishment of a separate asset account (e.g., inventory-subject-to-return account) or through separate disclosure, if material.

We believe the alternative view – considering a general right of return a performance obligation – does not represent the underlying economics of a sales transaction. Of particular concern is the potential for entities to recycle revenue. Reducing revenue by the standalone selling price of a general right of return is not the same as reducing revenue by estimated returns. Revenue could be significantly overstated in one period if there are substantial returns in a later period, which could lead to manipulation and might negatively impact users of the financial statements.

Another consequence of treating the return right as a performance obligation is the inappropriate accounting for the cost of returned inventory. Because the entity would not be unwinding the original sales transaction, the entity has to repurchase the inventory at the refunded value instead of accept the return of the inventory at its original cost. In effect, this would result in inflating the value of inventory to reflect the value of customer consideration never actually received. It is not clear in the Discussion Paper how entities would account for this repurchased inventory. Should the repurchased inventory be written down to estimated selling price? Should the subsequent sale of the repurchased inventory be at $0 margin? Would entities be required to use FIFO or other accounting for the repurchased inventory?

Both approaches create application questions that will need to be addressed by the Boards. While we clearly support the failed sale approach, we suggest the Boards enhance the current examples provided within the Discussion Paper to show the specific impact of each option on both the income statement and the balance sheet.

**Question 7**

*Do you think that sales incentives (e.g., discounts on future sales, customer loyalty points and “free” goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?*

We look forward to application guidance and enhanced examples in this area to help entities determine whether a sales incentive is a performance obligation. We agree some sales incentives, such as loyalty programs, should be considered performance obligations if they are provided in a contract with a customer and have stand-alone value to the customer. However, we believe certain types of sales incentives such as price protection and volume rebates should not be considered performance obligations and allocated a portion of the transaction price at contract inception. Reducing revenue by the standalone selling price of a price protection or volume rebate right is not the same as reducing revenue by estimated price protection or volume rebate payments. Revenue could be
significantly overstated in one period if there are substantial payments in a later period.

Instead, we believe price protection, volume rebates, and other similar sales contract provisions should be considered a reduction of the original transaction price. We believe the guidance in SFAS 48, Revenue Recognition When Right of Return Exists, and EITF 01-9, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor’s Products), is appropriate and should continue to be applied or incorporated into the proposed new standard.

Generally, we believe the substance of some incentive arrangements, such as discounts on future sales and “free” goods and services, differ significantly and therefore require different accounting. We recommend the Exposure Draft provide sufficient principles to determine when sales incentives should be considered performance obligations.

**Question 8**

*Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.*

We do not believe the singular focus on transfer of control – specifically, a focus on physical possession of the asset – is appropriate for determining when a performance obligation is satisfied. The focus on transfer of control may have a considerable impact on the timing of revenue recognition if control of an asset transfers at a different time from risks and rewards of ownership, and we do not think the focus on transfer of control provides clearer guidance or will result in more consistent decisions about when performance obligations are satisfied.

For example, the Discussion Paper does not address transactions involving third party providers such as delivery companies, logistics providers, or integrators. What is the impact, if any, of freight on board (“FOB”) shipping terms? The loss of control of an asset by the seller does not necessarily mean the customer has simultaneously gained control of the asset. In many cases, physical control may rest with these third party providers. If the seller and customer have come to agreement and documented when the risks of loss and rewards of ownership have transferred, we believe this is generally sufficient in determining when an asset has transferred to a customer and a performance obligation has been satisfied. Current revenue standards consider risks and rewards of ownership, and we believe these concepts are appropriate and should be incorporated into the proposed guidance.

Another area that needs to be addressed is the accounting for the transfer of a right to use intellectual property. While not specifically referenced, we believe the performance obligation relating to the transfer of a right to use intellectual property (e.g., a software license) is deemed to be satisfied at the date the right is provided to the customer, and not over the term of the license, (if a specified term exists), or over the estimated economic
life of the software product (if no term is specified or if the license is a perpetual license.

Question 10

In the boards’ proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

(a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

Yes. We agree the performance obligations should be measured initially at the transaction price because the transaction price represents the consideration the customer promises in exchange for the promised goods and services.

(b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity’s expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?

Yes, we agree that a performance obligation should be deemed onerous and therefore remeasured to the entity’s expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation. We generally agree with the cost test; however, we believe the Boards should provide additional guidance on which costs to include in the cost trigger. Should the costs only include direct costs, or should it include direct and indirect costs? If indirect costs are included, which costs will be appropriate to include, and on what basis?

In addition, we believe the onerous test should be performed at the contract level and not at the individual performance obligation level. The contract represents the combination of the rights and obligations between an entity and customer. Therefore, we believe performing onerous tests at the individual performance obligation level will result in unnecessarily complex analyses for most contracts with customers without a corresponding increase in decision-useful information.

Question 12

Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

Yes. We agree that the transaction price should be allocated to the performance obligations based on an entity's standalone selling prices of the goods or services underlying the performance obligations. Standalone selling prices are the most objective and reliable evidence of the fair value of performance obligations.
Question 13

Do you agree that if an entity does not sell a good or service separately, it should estimate the standalone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

Yes. We agree entities should be allowed to estimate the standalone selling price of goods or services for the purposes of allocating the transaction price. Revenue recognition should not be held to a higher standard than other critical areas of accounting where the use of estimates are required and allowed. For clarification purposes however, we recommend the Boards include a hierarchy of standalone selling prices to ensure consistent application. For example:

1. vendor specific evidence of standalone selling price
2. third party evidence of standalone selling price
3. management estimate of standalone selling price

Management estimates should be based on a reasonable valuation method and consistently applied.