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

International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

October 22, 2010

File Reference No. 1820-100, Exposure Draft: Revenue from Contracts from Customers

Dear Sir or Madam,

Thank you for providing the opportunity to comment on the Exposure Draft of the Proposed Accounting Standards Update entitled “Revenue Recognition (Topic 605): Revenue from Contracts with Customers”, issued June 24, 2010.

While we support the main objective of the FASB and the IASB to develop a common revenue standard for US GAAP and IFRS, we do have concerns and clarifying questions regarding some of the tentative conclusions reached by the Boards. The key areas of concern are:

1) the identification of performance obligations
2) the measurement and presentation of the impact of credit risk on revenue
3) the impact of time value of money on revenue recognition
4) accounting for warranties; and
5) the required retrospective adoption and disclosures

In the absence of additional clarifying guidance, we believe that divergent practices may lead to reducing the usefulness and effectiveness of financial statement information to investors. In addition, we would like the Boards to consider the cost/benefit trade off for the significant increase in operational complexity for financial statement preparers.

The discussion below outlines our concerns and comments in our responses to the questions posed in the Exposure Draft:

**Key Concerns**

**Question 2 – Performance Obligations:** The Boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

Response: We generally agree with the proposed standard, but we would like the Boards to provide clarification on identification of performance obligations for 1) perpetual software licenses that are rarely sold separately, and 2) software subscriptions and hosted services.
As noted in the proposed standards, an entity can conclude that a good or service is distinct if the entity could sell the good or service separately and it has a distinct function and distinct profit margin. Paragraph 23(b)(ii) states that a good or service has a distinct profit margin if it is subject to distinct risks and the entity can separately identify the resources needed to provide the good or service. For software licenses that are not sold separately, entities may not be able to separately identify the resources needed to develop the software from the resources providing PCS to customers, therefore they may not be able to demonstrate a distinct profit margin. In such instances, software licenses would not be accounted for as a separate performance obligation. We don’t believe that this is an accurate depiction of the economics of the transaction as software licenses are deemed to be a separate obligation and should be accounted for accordingly. We propose that the Boards please clarify the distinct profit margin standard and consider that a good or service can have a distinct profit margin if the entity has a reasonable basis to estimate a profit margin.

For subscriptions and hosted services, does the proposed standard require the bifurcation of a software term license and PCS included in a subscription or hosted service when it is delivered over the same period?

For example, Entity A sells a subscription service which always includes a term based software license bundled with post-contract support (PCS), and is not sold separately. In this situation, the proposed standard is unclear as to whether it would be necessary to apply the recognition and measurement requirements to each performance obligation. We believe that if promised goods or services are delivered to a customer over the same time period, as in a subscription or hosted services, it should not be a requirement to account for each performance obligation separately.

**Question 5 – Credit Risk:** Paragraph 43 proposes that the transaction price should reflect the customer’s credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer’s credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue? If not, why?

Response: It is our opinion that the requirement to reflect the customer’s credit risk in the transaction price may lead to inconsistency in practice between entities based on the level of subjectivity of estimates. In addition, this proposed standard could significantly impact recorded gross margins due to the subsequent adjustment of revenues for initial estimates of credit risk and would not reflect the true economics of the transactions.

To illustrate, assume a software sale by Entity A to a new customer in an emerging market that is deemed material to the quarterly financial statements.

Entity A may conclude that it could not reasonably estimate the transaction price with the new customer due to a lack of history with this specific customer, as well as a lack of history with the particular geography of this customer. In this scenario, the proposed standard would suggest that it is appropriate to recognize $0 revenue with the delivery of goods/services. If the entity subsequently collects 100% of the total consideration, it would still not recognize any revenue, but recognize 100% of the subsequent cash receipt as a gain or other income in the financial statements.
Conversely, Entity B may conclude that it can reasonably estimate that it will collect 80% of the transaction as it has a history in the geography or with the particular customer, so it would recognize 80% of the transaction price. It would then recognize 20% as other income or gain upon cash receipt.

As illustrated above, the accounting and presentation of effectively the same transaction could vary significantly from one entity to another. As such, it would reduce the comparability of financial statements and would not provide useful information to investors. In addition, this model would not provide an accurate representation of the economics of an entity’s revenue arrangements, as the amount of revenue recognized may have no relation to the amount of consideration received from these arrangements. We believe that the level of subjectivity and use of estimates under this model could also mislead and confuse the users of financial statements. As such, we believe a customer’s credit risk should continue to be accounted for through bad debt expense, not as part of the transaction price.

**Question 6 – Time Value of Money:** Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

Response: In evaluating the proposal that an entity should adjust the amount of consideration to reflect the time value of money if the contract includes a material financing component, we request the Boards to clarify what would constitute a material financing component. For example, would it include instances of an advance payment on annual contracts where services are being delivered over time?

Assuming the Boards consider the above example as providing a material financing component, we don’t agree that adjusting the amount of revenue to reflect the time value of money should be required. The complex calculations and analysis required to adjust the transaction price for these types of transactions would introduce a significant level of complexity that is not easily understandable by the primary users of the financial statements.

As an example, it is a customary business practice for software customers to pay post-contract support (PCS) annually in advance. Assuming a customer signs a 3 year agreement for PCS to be paid in 3 annual installments at the beginning of each year, the proposed standard would require us to perform a present value calculation of these annual payments. We would then adjust the transaction price based on the present value calculation and could potentially recognize more revenue than what we expect to collect in cash. We believe that this gross up of revenue would not yield any incremental or decision useful information for our investors. In addition, determining the materiality of the time value component in multiple element arrangements would result in a significant amount of operational complexity and costly implementation that would outweigh any benefits to users of the financial statements.

We propose that the Boards allow consideration of an entity’s business practices and timing of its normal business cycle in determining if its contracts include a material financing component that needs to be analyzed for time value of money. If it is the entity’s business practice to collect upfront for multi-year contracts or to offer extended payment terms, then it may determine that there is not a material financing component in its normal business transactions or contracts.
**Question 15 - Warranties:** The Boards propose that an entity should distinguish between the following types of product warranties: (a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract. (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract. Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

Response: We don’t agree with the distinction between a latent defects warranty and a post-transfer defects warranty. We believe that standard warranties provide customers with a contractual right, which guarantees that the delivered product will function according to specifications for a certain period of time. We believe that standard warranties are contingent costs associated with delivering products as specified. Standard warranties should not be viewed as performance obligations but as costs associated with delivering product. Therefore, we believe that warranties should continue to be accounted for under ASC 450 (FAS 5), Accounting for Contingencies.

We would also like the Boards to clarify the application of the proposed accounting treatment as it relates to software warranties. It is typical in the software industry to provide a short term warranty (which is not sold separately) for the first 90 days of a license purchase, where the software may be repaired, replaced, or fees refunded, at the company’s discretion. In addition to the short term warranty, customers will also purchase PCS for the same time period. In this scenario, PCS covers the same obligations for bug fixes, updates, and upgrades as the standard warranty. As such, we would like the Boards to allow for the warranty obligation to be accounted for together with the predominant performance obligation as opposed to accounting for it separately, when the warranty is not sold separately. In our example, since PCS is the predominant performance obligation, there would be no requirement to account for the warranty as a separate obligation, since PCS is already deferred and accounted for ratably over the performance period.

**Question 10-12 Disclosures (paragraphs 69–83):** The objective of the Boards’ proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

Response: While we agree with the need to ensure that users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, the proposed disclosure requirements appear to be excessive and onerous for entities to prepare and track, and may not provide information that is decision useful or meaningful to financial statement users.

In our view, the costs of documenting the reconciliation of contract balances as required by paragraph 75 outweigh the benefits. A large corporation would be overburdened pulling together all of the listed requirements for thousands of transactions. The amount of information required and man hours needed to provide a reconciliation to the ending balances would be unreasonable.
Customers often enter into multi-year transactions but it is not practicable to track the quantity of contracts over the suggested periods. In addition, revenue streams for multi-year contracts are not always fixed values and may differ from month to month or quarter to quarter. For example, royalty payments would need to be estimated and re-estimated which would lead to excessive tracking issues and potentially misleading financial statements. Detailing expected performance obligations out 2-3 years in advance may be subjective and also reduce the comparability of the financial statements. In the event cancellation language is included in contracts, this may further result in complexities when estimating performance obligations over the required periods.

Due to the volume of contracts, multitude of products and services, as well as the complexity of arrangements, the application of paragraph 78 results in operational complexity and significant implementation costs which far outweigh any benefits to the users of this financial information.

We agree with the need for Disaggregation of revenue but believe the Segment Information, Geographical information and Significant Customer information already required in the financial statements to be sufficient.

**Question 13 – Retrospective Adoption (paragraphs 84 and 85):** Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why? Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

Response: We don’t agree with the retrospective reporting requirements in the proposed standard. The proposal would effectively require maintaining two separate sets of records prior to convergence. This requirement would be onerous and would not be practical in the proposed timelines. We would like the Boards to consider using the same requirements implemented in ASU 2009-13 (EITF 08-1) and ASU 2009-14 (EITF 09-3) with respect to retrospective adoption and disclosures. In those cases, prospective application was required as of the beginning of the fiscal year during which the new standards were adopted. The option of retrospective application was provided if the Company met the practicability requirements in ASC Topic 250 (Statement 154) for retrospective application. We believe that this guidance is sufficient for our financial statement users and will be more manageable from an operational and cost perspective.

**Question 14 – Implementation Guidance (paragraphs IG1-IG96):** The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance. Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

Response: We would like the Boards to consider more clarifying guidance and examples in all areas, but particularly, to areas that are noted within this comment letter.
Clarification Comments/Questions

Question 1 – Price Interdependence: Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether to:
(a) combine two or more contracts and account for them as a single contract;
(b) segment a single contract and account for it as two or more contracts; and
(c) account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

Response: We generally agree with the proposed principle on price interdependence but would like more clarification and examples of the segmentation requirement.

For example, A contract is entered into to sell software license, post-contract support (PCS) for the license, and professional services for $200. The contract components have established standalone prices of: License $90; PCS $50; and Professional Services $100. Professional services are typically not discounted regardless of whether it’s sold on its own or with other elements. Under the proposed standard, the professional services will be segmented from the software license and PCS.

Based on our understanding of the proposed standard, in the above scenario, professional services can always be segmented from the other elements of the contract, and the $40 discount will be allocated only to the license and PCS.

We would also like the Boards to clarify if segmenting a single contract and accounting for it as two or more contracts is a requirement, or can an entity elect an accounting policy not to segment for contracts as in the example noted above? If this is a requirement, we would like the Boards to consider that for companies with a high volume of transactions, this requirement would be onerous as entities would have significant system limitations and issues with tracking and segmenting these contracts.

Question 4 – Variable Consideration: The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?

Response: We would like to obtain clarification and implementation guidance on estimating the transaction price when we have variable consideration, particularly, in relation to royalty payments received from our OEM partners. As an example, would we estimate how much royalties we expect to receive over the life of the contract? Or would we be required to estimate the quarterly payments at the beginning of each quarter based on historical data? We believe that estimating variable consideration is very subjective and would lead to incorrect estimates that would require adjustments to the financial statements. This could lead to excessive operational issues related to tracking and re-
assessing the estimates, as well as confuse the financial statement users due to quarter over quarter adjustments. In addition, due to the subjectivity of estimating the transaction price for variable consideration, we believe that it would diminish the comparability of financial statements.

To illustrate, assume a 3 year OEM agreement, where revenue is recognized when the royalty reports are received from the partner, which is usually one quarter in arrears. Does this model require the entity to estimate the quarterly revenue in the quarter (1) when revenue is earned, (2) when it receives the partner revenue information, or (3) would it be required to estimate the total revenue at inception of the 3 year term?

**Question 7 – Allocation of Transaction Price:** Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

Response: We generally agree with the allocation of transaction price to all separate performance obligations in a contract based on standalone selling price. However, we would like the Boards to reconsider the option to use the residual value when determining the estimated standalone selling price, particularly with respect to software licenses. In establishing the stand alone selling price for a software license (which are typically not sold on their own), using an estimate of standalone selling price becomes very subjective and therefore may not reflect the true economics of a software license sale.

Per BC125 of the draft exposure, “the Boards confirmed that the residual method should not be used to allocate the transaction price to separate performance obligations. However, the Boards noted that a residual or reverse residual technique may be an appropriate method for estimating a standalone selling price if there is a directly observable price for one performance obligation but not the other.” It is unclear as to whether it is the Board’s intent to allow the use of residual value when establishing a standalone selling price. We believe that the use of residual value may be an appropriate method for establishing a standalone selling price and should be available as a data point in the determination of a standalone selling price. We ask that the Board confirm that this is the intent of BC125.

**Question 8- Contract Costs:** Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, Topic 330 or IAS 2; Topic 360 or IAS 16; and Topic 985 on software or IAS 38, Intangible Assets), an entity should recognize an asset only if those costs meet specified criteria. Do you think that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient? If not, why?

The proposed guidance indicates that costs incurred in fulfilling the contract can be treated as an asset if they relate directly to a contract, help satisfy a future obligation and are expected to be recovered.

We would like the Boards to clarify if the proposed standard requires that we capitalize all fulfillment costs including those associated with short term consulting projects. Can materiality be
considered in determining whether or not to recognize an asset for such costs? We believe that this requirement would pose significant operational difficulties in order to comply with the tracking obligation and would require significant investment of time and resources in order to track costs and evaluate future benefit.

Example: Company A is entering into a 3 month consulting project and spends the prior month creating projects plans and training material for this customer. In this situation the project plan and training material are directly related to the project and will enable fulfilling future performance obligations and these costs will be recovered through the consulting revenue. In this scenario, is the company required to track the time and expense spent by each individual associated with the project plan?

Also, should fees such as travel expenses or transaction fees paid to a partner be capitalized as they are directly related to a contract?

**Question 9 – Onerous Obligations:** Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation. Do you agree with the costs specified? If not, what costs would you include or exclude and why?

Response: We don’t agree that a gain or loss should be recognized for each performance obligation within a contract. Typically, pricing of the various performance obligations within a contract are dependent on each other since they are negotiated in contemplation of one another. Therefore, the stated price in the contract is not necessarily the appropriate measurement to calculate the true profitability of that performance obligation. As such, we believe that a gain or loss should be determined based on the total contract value instead of the individual performance obligations.

Furthermore, as most contracts include multiple performance obligations, the requirement to analyze each performance obligation on thousands of contracts would not be operationally feasible.

**Question 16 – Exclusive and Nonexclusive License:** The Boards propose the following if a license is not considered to be a sale of intellectual property:
(a) if an entity grants a customer an exclusive license to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the license; and
(b) if an entity grants a customer a nonexclusive license to use its intellectual property, it has a performance obligation to transfer the license and it satisfies that obligation when the customer is able to use and benefit from the license. Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the patterns of revenue recognition proposed by the Boards? Why or why not?

Response: It is our opinion that exclusivity should not determine the patterns of recognition and we would like the Boards to reconsider this proposed standard or provide clarification on how this is appropriate for intangible products such as term based, perpetual, or subscription software licenses.
To illustrate, if a software product is currently sold under term, perpetual, or subscription software license with PCS, and where the combined unit of accounting would currently be recognized over the term as a subscription, should the license be separately valued and recognized upon transfer of control? Does the proposed standard intend to effectively remove subscription accounting for non-exclusive licenses?

**Consideration Payable to the customer:** Paragraph 48 states that if an entity pays or expects to pay consideration to the customer, in the form of cash or credit, or other items that the customer can apply against amounts owed to the entity, the entity shall determine whether the amount is:

a) A reduction of the transaction price, and hence, of revenue

b) A payment for a distinct good or service, or

c) A combination of items (a) and (b)

Response: We would like the Boards to clarify if the intent of the proposed standard is to be consistent with the current practice under ASC 605-50 (EITF 01-09). Currently, under ASC 60-50, there is a presumption that cash consideration payable to the customer is a reduction of the selling price of the vendor’s products or services. The presumption is overcome if the vendor receives an identifiable benefit and the vendor can reasonably estimate the fair value of that benefit. Based on the example provided on slotting fees, it is uncertain whether the analysis is consistent with current practice. ASC 605-50 specifically notes that product placement (slotting fees) and similar fees will generally be characterized as a reduction of revenues, but the proposed standard concludes that slotting fees are a distinct service. It is unclear in the example as to whether the analysis was based on the same concepts under current guidance or if there is a distinct difference in how consideration payable to a customer is to be analyzed under the new standard. We would like the Boards to clarify the intent of Paragraph 48 and more clearly identify the differences from current practice and provide implementation examples.

Thank you for your consideration of the concerns outlined in this comment letter. If you have any questions or would like to discuss our responses further, please contact me @ 650-527-6177.

Sincerely,

Phillip Bullock
SVP, Chief Accounting Officer