October 22, 2010

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

Re: Proposed Accounting Standards Update of Topic 605 (Revenue Recognition)

We are pleased to submit our comments for your consideration regarding the exposure draft on revenue recognition published by the Financial Accounting Standards Board and International Accounting Standards Board (collectively referred to as the Boards). We fully support the Boards’ efforts to clarify the principles for recognizing revenue and develop a common standard for use both in the U.S. and internationally. Our review of the proposed standards has identified concerns principally related to the continuous transfer of goods and services, revenue collectability, and retrospective application, and our intent with these comments is to improve the standard.

Union Pacific Corporation owns one of America’s leading transportation companies, Union Pacific Railroad Company (UPRR), the largest freight railroad in North America in terms of revenues. UPRR routinely transports 8 million to 10 million carloads of freight annually for thousands of customers, resulting in the generation of more than 5 million revenue transactions.

Continuous Transfer of Goods and Services

In the railroad industry, revenues earned for the transportation of freight are allocated between reporting periods based on relative transit time in each reporting period with expenses recognized as incurred. This methodology, which in our opinion is equivalent to the continuous transfer of goods and services methods, was adopted by the railroad industry after the issuance of EITF Issue 91-9, Revenue and Expense Recognition for Freight Services in Process (partially codified in ASC 605-20-25-13). This method of revenue recognition ensures that revenues and related expenses are recognized in the same reporting period as services are transferred and as costs are incurred.
Under the proposed guidance, an entity would recognize revenue when it satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service. Although the exposure draft allows for the recognition of revenue for separate performance obligations that are transferred to a customer continuously, we feel that it would be beneficial if clarification was provided in the guidance for situations related to transportation service providers. Within our business, a customer has the ability to direct the use of and receive benefit from our services because the customer may sell the goods while they are in transit on our system and/or the customer may change the destination point while the goods are in transit. Therefore, we believe that we satisfy our performance obligations as we are providing transportation services, and we would expect that revenues would be recognized continuously as we move goods from origin to destination. However, there are limited examples in the implementation guidance of the exposure draft that deal with service providers and with the application of the continuous transfer of goods or services methods. Specifically, we request that the Boards [i] provide additional examples related to the application of the continuous transfer of goods or services methods and [ii] clarify the process for assessing whether a customer has obtained control of a service to satisfy a performance obligation.

In the Discussion Paper, Preliminary Views on Revenue Recognition in Contracts with Customers, issued by the Boards in December 2008, the Boards provided the following conceptual description of “services” in paragraph 3.13:

3.13 A service also can be an asset promised by an entity in a contract with a customer. Although a service typically is not thought of as an asset, the Boards have explained that concept in existing literature:

Services provided by other entities, including personal services, cannot be stored and are received and used simultaneously. They can be assets of an entity only momentarily—as the entity receives and uses them—although their use may create or add value to other assets of the entity. [Concepts Statement 6, paragraph 31]

Although services to be received in the future might not meet the definition of an asset, services are assets when received. These assets are usually consumed immediately. [IFRS 2, Share-based Payment, paragraph BC47; footnote reference omitted.]

Paragraphs 3.14 through 3.17 of the Discussion Paper provide additional clarification of services. Furthermore, paragraph 4.7 discusses the transfer of services to customers:

4.7 Similarly, to determine when a service is transferred to a customer, an entity assesses whether the customer has received the promised service. In some cases, that service enhances an existing asset of the customer. In other cases, that service is consumed immediately and would not be recognized as an asset (paragraph 3.13).
Although the paragraphs cited in the Discussion Paper do not change the underlying theory related to the application of the continuous transfer of goods or services method, it would be helpful if the discussion was incorporated into the Accounting Standards Update of Topic 605 (Revenue Recognition) in order to clarify the concept that a customer must obtain control of a good or service to satisfy a performance obligation. We also recommend that the implementation guidance include an example or examples that illustrate the continuous transfer of services such as transportation services.

Collectibility

The Boards have proposed that, when determining the transaction price, an entity should reduce the amount of promised consideration to reflect a customer's credit risk. It has also been proposed that an entity record all future adjustments to a customer's credit risk, principally to reflect actual collections, through other income or expense. We do not believe that reducing revenue in some instances and recording other income or expense in others will provide financial statement readers meaningful information about an entity's performance. In fact, we believe that there will be less transparency than today.

In our opinion, the subjective nature of credit risk could enable an entity to overstate or understate revenues. Alternatively, revenue could be affected by an entity's collection efforts rather than a customer's actual credit risk. By reflecting the assessment of collectability in the transaction price but recording future adjustments to other income or expense, investors may be mislead as to the actual revenues that are earned in the ordinary course of business.

Taking into consideration the judgment that would be involved in the initial and subsequent assessments of credit risk, we believe that requiring a change to the existing practice of accounting for potential losses through an allowance for doubtful accounts would not provide investors with more meaningful information as it relates to an entity's revenues, collection efforts, and customer credit risk. Material losses due to the inability of an entity to collect on accounts receivable is reflected in current practice and disclosure of the accounting policies and methodologies an entity uses to estimate its allowance for doubtful accounts is required under ASC 310-10-50-9. Any changes that would incorporate more judgment and allocate ultimate collection losses between revenues, income, and expenses should not be adopted.

Retrospective Application

Although applying the proposed standards retrospectively may preserve trend information, we question whether the benefits to financial statement users outweigh the costs to companies. Based on our preliminary assessment, we believe that it may be extremely costly or impractical for us to apply this guidance retrospectively. It may be necessary for us to operate and maintain parallel revenue accounting systems for a period of time, requiring additional personnel and duplication of other resources in our accounting department. In addition to an increase in our operating costs, we fully
expect that our audit fees will increase as our auditors will need to review two years of revenue transactions twice and evaluate the controls in two revenue accounting systems.

We also request that the Boards give careful consideration to the effective date of these new rules because of the amount of lead time required to make modifications to our existing revenue systems. If adequate time is not given to allow for the modification of our revenue systems, it will be impractical or impossible to retroactively apply this standard given the significant volume of transactions that we process each year.

We ask that you consider the duplication of resources and the cost of such duplication as well as the effective date before requiring the retrospective application of any standard that has such a profound impact on an entity’s accounting operations.

If you have any questions in relation to this letter, do not hesitate to contact me at 402-544-0030.

Sincerely,

Jerry Gose
Assistant Vice President – Financial Reporting
Union Pacific Railroad Company