October 22, 2010

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Dear Chairmen:

The Financial Reporting Committee ("FRC") of the Institute of Management Accountants is writing to provide its views on key issues raised by the Exposure Draft - Revenue from Contracts with Customers (the "ED").

The FRC is the financial reporting technical committee of the IMA. The FRC includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics, and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

Overall, we are supportive of the project and the general approach outlined in the ED to have one source of literature for revenue recognition. We understand that the Boards have made efforts to reach out to constituents in a variety of industries to better understand the effects of the ED's principles. Given the significant implications that this guidance will have on all industries, we encourage the Boards to robustly field test the model (including with industry investors) to ensure that the proposed model is operational and provides decision-useful information across all industries. In addition, we note that much of the detailed guidance in US GAAP has been developed over many years to address unique situations, areas of diversity in practice or matters where existing guidance may have been unclear. We believe the Boards should evaluate the underlying issues that gave rise to the existing detailed guidance to evaluate whether similar issues are likely to arise in the future in applying the new standard. It would seem appropriate that such an evaluation take place as part of the Boards' field testing efforts. We also encourage the Boards to make public major concerns raised during its industry outreach and field testing so that others in those industries can benefit and better understand the potential impact of the proposed model.

We acknowledge that developing a single revenue recognition model is challenging given the broad array of transactions and markets that exist. While we encourage the Boards to limit industry exceptions, we also believe that the Boards should be willing to modify general guidance or scope when its application does not reflect the underlying economics of revenue generating transactions. It is very important that we not lose sight of the fact that investors find revenue recognition to be a critically important metric because of its inherent link to the generation of cash flows. To the extent that the principles in the ED cannot be adapted to appropriately reflect the underlying economics of revenue generating transactions and their related cash flows in all industries, we believe the Boards should evaluate modifications to the scope of the final standard. As further discussed in this letter, we are concerned that the proposed
model might not accomplish this goal for long-term construction or production-type contracts and certain licensing transactions.

We believe the Boards have made substantial progress in developing and improving the model since the Discussion Paper. However, we have concerns that applying certain aspects of the proposed model may result in not appropriately reflecting the economics of the underlying transactions and that certain aspects of the proposed model need to be further clarified to be operational. In addition to the matters addressed in this cover letter, we have provided more detailed information regarding these concerns in Appendix A to this letter.

Transfer of Control
We generally agree with the concept that revenue results from the satisfaction of performance obligations (i.e., when control transfers). However, additional guidance is needed to understand when control is transferred in service arrangements, particularly on whether control transfers continuously or at the end of the service. We believe the indicators in paragraph 30 of the ED are more useful in the context of evaluating when control of a good has transferred. Because the nature of providing a good or a service is inherently different, we believe that separate indicators should be developed to illustrate the concept of a transfer of control for service arrangements. The indicators may include consideration of whether the customer immediately obtains benefit from the entity's activities or whether each task performed further progresses towards completion of the performance obligation.

We are also concerned that applying the control principle to some long-term construction or production-type contracts will not result in decision-useful information when control is not deemed to transfer until the end of the contract. The proposed accounting for such contracts may not reflect the progress that is being made and the economic value being created under such long-term contractual arrangements. Contract accounting should reflect the cash generating activity that is occurring (e.g., producing an asset or performing a service) to meet the buyer's specifications. We acknowledge the indicator in paragraph 30(d) was included to address some of these concerns; however, it is unclear why the customer's ability to specify the design or function of a good or service indicates that control has transferred. That is, does significant customization provide for "effective control" or would ownership of the partially completed good or service (e.g., work-in-process, work papers, or logs) also be required to support transfer of control? To avoid a situation that would potentially result in diminished decision-useful information, we believe that these contracts should be accounted for consistently with current guidance (e.g., by applying the proportional performance model). We believe the proportional performance model better reflects the ultimate right of ownership for long-term contracts. This can be accomplished by explicitly stating that control of the good or service in these contracts is deemed to continuously transfer to the customer. Such an approach is not at odds with the substance of such arrangements and provides a more representational view of the underlying economics. In addition, because these contracts are essentially service-type contracts, we also propose that long-term service contracts be included within the scope of this clarification.

Variable Consideration
We agree that revenue should be recognized using an estimated transaction price. However, we believe that the threshold for recognition should be raised such that the amount of consideration is both probable ("highly probable" under IFRS) and reasonably estimable. Investors place significant emphasis on revenues when developing their future cash flow estimates. Because of this importance, we believe that a high threshold is appropriate to support recognition. Recognition of variable consideration prior to such amounts being probable may cause confusion among financial statement users, complicate analysis of performance and potentially increase the risk of litigation when significant differences between actual and estimated performance occur. We are also concerned that increased diversity in practice may develop due to differences in good faith judgments being applied in similar fact patterns. This diversity in practice would hinder investors' ability to compare companies within industries.

We also believe that a single best estimate approach should be permitted. We do not understand how recording a probability-weighted amount that is certain not to occur (such as for binary outcomes) reflects the underlying economics or provides decision-useful information. The use of a probability-weighted amount also may present operational difficulties as the requirement to assess all possible outcomes and assign a probability to each outcome will require significant effort for many companies. We believe that the related costs of those efforts will exceed the perceived benefit.

Lastly, we believe additional guidance is necessary to address situations in which the variable amount is not reasonably estimable at the reporting date but is reasonably estimable prior to the issuance of the financial statements. Consider an arrangement in which a film studio agrees to receive variable fees for a film that is released in theatres (on a nonexclusive basis) prior to the end of the reporting period (e.g., a December holiday release date). At the reporting date, the studio determines that the theatrical box office receipts are not reasonably estimable and
therefore, no revenue is initially recorded. Prior to the release of the financial statements, in the subsequent period, the studio determines that the amount of the theatrical box office receipts is reasonably estimable. We believe this would be common as a film’s expected performance is generally reasonably known within several weeks of its release based on actual box office receipts. Some may interpret the guidance to recognize this situation as a nonrecognized subsequent event based on the language in paragraph 41 of the ED that states that an entity shall recognize revenue from satisfied performance obligations when the transaction price can be reasonably estimated. Others may consider this situation to be a recognized subsequent event because control of the nonexclusive license transferred during the prior reporting period. Accordingly, we envision that diversity in practice might develop in these situations.

Collectability
We do not agree that customer credit risk should affect how much revenue is recognized by an entity. Revenue is a key performance metric utilized by users of the financial statements and a high threshold should be considered when recognizing revenue. Therefore, we believe customer credit risk should continue to affect when an entity recognizes revenue and that revenue should not be recognized prior to contractual amounts being probable of collection (consistent with our proposed threshold for variable consideration). We also note that many systems currently utilized are designed to recognize revenue based on invoiced amounts. Accordingly, the Boards should reconsider whether the perceived benefits of this change outweigh the anticipated costs as significant expenditures may be incurred in order to implement the proposed standard. Costs can only be estimated through robust field-testing.

We are also concerned that changes in collectability assessments affect bad debt expense/income rather than revenue. This will result in a disconnect between the amount of revenue recognized and the transaction price and is inconsistent with the premise of the proposed model (that is, revenue is based upon the contract transaction price). This may increase user confusion since cash flows from revenue generating activities would be excluded from gross margin. Consider a scenario where there is an equal chance that collectability will occur in full or not at all but management is willing to accept the risk of non-payment for various business reasons. If the customer ultimately pays in full, fifty percent of the company’s revenue would not be recorded as revenue but as a reduction of bad debt expense. We believe this is inconsistent with how investors would view the economics of such a transaction.

Time Value of Money
We conceptually agree 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. For practical reasons, however, we believe that the concept should only be applied when payment is received at least twelve months before or after transfer of control. We note that even if an entity ultimately determines that a material financing component does not exist, some may believe they need to quantitatively demonstrate that fact (rather than performing a qualitative assessment). We highlight that this change would be consistent with the FASB’s proposed guidance for short-term receivables and payables in the financial instruments project where a twelve month practical expedient was provided. In addition, we believe the interaction between the ED and the financial instruments guidance is unclear. For example, would time value of money be imputed while a contract asset exists (under the ED) but then no longer be imputed once a receivable exists if ultimate settlement will occur within twelve months?

We also request that the Boards provide additional guidance on how the time value of money concept would be applied. Depending on the situation, we believe in certain cases the application is either not intuitive or is unclear. Examples include:

- Situations with multiple performance obligations or variable consideration,
- Whether the discount rate would be established at inception or continuously updated throughout the life of the contract, and
- Situations where the payment is anticipated but the timing of receipt of such payment is not reasonably estimable (i.e., would revenue recognition be precluded?)

Codification Amendments
We strongly oppose the FASB’s recent decision to not expose the Codification amendments that would result from this (and other major) projects. We are concerned that this decision is not consistent with the FASB’s due process requirements. Constituents need to have a complete understanding of how existing guidance might be affected to fully respond to the proposals. This is particularly important in this project in order to fully understand how existing cost, real estate, and other industry guidance is affected by the Boards’ decisions. Therefore, we request that the FASB expose the Codification amendments for this project to obtain this critical feedback.

Onerous Performance Obligations
We agree that an onerous test should be included within the model. However, we believe that applying the onerous assessment at the performance obligation level does not reflect the underlying economics of many transactions.
Entities that enter into contracts anticipating losses on certain performance obligations even though the overall contract is expected to be profitable may be negatively affected by requiring this assessment at the performance obligation level. In addition, users of financial statements might be confused when trying to reconcile the overall economics of such an arrangement with the loss recorded for an onerous performance obligation. We believe the onerous test should be applied at the contract level or higher, depending on the nature of the transaction. The principle in the ED could lead to recognizing day one losses in certain situations. We believe this accounting does not appropriately reflect the overall economics that take place when an entity obtains a profitable contract with a customer. We also believe that only direct and incremental costs should be used for purposes of applying the onerous test. We believe this change would provide more useful information for contracts that are accretive to earnings when they cover variable costs (but would not be sufficient to cover allocated fixed costs).

Additional guidance is also needed on how the onerous test should be applied when variable consideration cannot be reasonably estimated or when an entity prices certain contracts at a loss (based on allocated costs) with the expectation that a group of contracts would be profitable - for example, airline seat tickets.

Licensees of Intellectual Property
We believe the proposed model for the license of intellectual property does not reflect the underlying economics of the transaction and is inconsistent with the performance obligation model outlined in the ED. If the performance obligation is to license intellectual property, and no additional service or obligation is required by the licensor, it is unclear why the proposed model focuses on whether the license is "exclusive" or "non-exclusive". The timing of recognition should depend on whether a performance obligation has been satisfied, consistent with the overall principle noted in the ED. Exclusivity should be considered in determining the transaction price rather than the pattern of recognition, as an exclusive license is more valuable from the perspective of the licensee and licensor.

It is also unclear how exclusivity and unit of account should be defined in a license of intellectual property. Although the implementation guidance provides some indicators to be considered to determine exclusivity, further guidance would be helpful regarding how to determine exclusivity based on geography, time slots, etc. We believe inconsistencies will emerge among companies that regularly license intellectual property based on different assessments of whether a license is exclusive or nonexclusive.

Contract Modifications
We agree that recognizing the cumulative effect of a modification might be appropriate in some situations. However, we are concerned that accounting for a modification as a cumulative change in estimate will not always best reflect the economics or business rationale for a modification. The accounting should reflect the facts, circumstances and economic substance of the modification. We believe that modifications should generally not immediately affect earnings and that cumulative effect adjustments should be limited. Included in our response to Question 1 are indicators we believe should be considered in determining whether a modification should be accounted for on a prospective basis or through a cumulative effect adjustment.

Options
We have concerns that the guidance for options will not be operational in situations when the future price of the underlying good or service is highly variable. This may be particularly challenging when an entity includes, as a regular commercial practice, an option in their contracts. For example, media companies generally license the initial rights to air a television show to one television network. The media company always provides the network with the right to renew the license for future seasons, generally at increasing fixed prices, consistent with industry practice. Under the ED, the media company would likely need to determine a hypothetical value of the pricing of future seasons in order to apply the guidance. However, those values can and do fluctuate significantly based on the success of the show each season. We believe additional guidance is needed to help understand how options would be valued in such situations.

Transition
We agree with the Boards that retrospective application of the proposed requirements will provide consistency among entities and should be a permitted transition approach. However, we have significant concerns that it will be impracticable to apply the guidance retrospectively in many situations. Examples of difficulties that we believe will be encountered on a frequent basis unless the related proposed guidance is changed - or specific transition consideration is provided - include the following:

- Significant variable consideration exists that requires a high degree of estimation. In the absence of historical documentation to substantiate what management's estimate would have been under the proposed guidance, we believe it will be difficult to objectively determine the reliability of historical estimates.
• Application of the time value of money concept, particularly when upfront or advance payments are present since time value has generally not been considered under current practice.
• Incorporating credit risk into the initial measurement of the transaction price and reclassifying provisions between bad debt expense and revenue.
• Application of the guidance in long-term construction or production-type contracts when the contract level is no longer considered the unit of account (i.e., greater performance obligations exist).
• License transactions for several reasons including (1) significant changes could occur for entities that would be required to defer revenue when it had previously been recognized at license inception (2) determining the related effects on cost recognition and (3) estimating past variable consideration would be challenging.
• Application of the onerous test particularly since losses are generally not recognized on executory contracts under current guidance.
• Bifurcating warranty obligations between latent defect and performance obligation warranties.
• Valuing options in contracts that had previously not been assigned value.

We believe the costs to apply the standard retrospectively will be significant, even in those situations where it is not deemed impracticable. We therefore recommend that a prospective transition alternative be provided. This approach would be consistent with the transition alternatives provided under other significant revenue guidance changes such as EITF 00-21, ASU 2009-13 and ASU 2009-14. We believe providing this alternative, when supplemented with clear disclosure of the impact of the change for a reasonable period of time, appropriately balances the trend information needs of users with the burden and costs to preparers.

However, if the retrospective application requirement is retained, we suggest the final standard include language that the Boards acknowledge that the guidance may be impracticable to apply retrospectively, particularly where significant historical estimates are required and were not contemporaneously documented.

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To the extent there are significant changes to the current exposure draft, we strongly suggest that the Boards re-expose the proposed standard for further review and comment considering the importance of revenue.

Members of the FRC would be pleased to answer any questions you may have regarding our response. Please feel free to contact me at (212) 484-8112 if you would like to discuss specific issues.

Sincerely,

Allan Cohen
Chair, Financial Reporting Committee
Institute of Management Accountants
Question 1

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?

We agree with the proposed principle of combining two or more contracts and accounting for them as a single contract if they are price interdependent. Similarly, we agree that a single contract should be segmented into two or more contracts if the price of some goods or services in a contract is independent of the price of other goods or services in a contract. However, additional clarification would be helpful for contracts where revenue is earned from multiple parties. For example, consider a credit card company that also offers its customers a loyalty program. The loyalty program may not be profitable when evaluated in the context of expected revenue from the cardholder perspective. In some cases, no revenue may be received from the cardholder. However, the arrangement is profitable overall when transaction fees received from third parties (i.e., merchants) are considered. It is unclear to us whether contracts with multiple customers should or can be combined when applying the model.

We believe that a different principle and indicators should be developed for modifications. In our opinion, the indicators noted for combining a contract modification with the existing contract are not as relevant to a modification. That is, a modification is typically signed at a later date (potentially at a date significantly after the original contract date), may not be negotiated as a package with the existing contract as the modification may be due to current economic factors (e.g., changes in price of raw materials), and obligations may not be performed concurrently or consecutively. Accordingly, because the economic considerations for a modification are different from those made at contract inception, we believe different combination principles should be applied. We are concerned that cumulative effect accounting will not always best reflect the economics or business rationale for the modification. For example, a company may be willing to provide discounts or modify their future pricing for valid business reasons (i.e., to obtain additional goods, retain existing customers to a longer term service, expand their presence in new markets or products) that should not affect the accounting for goods or services that had already been provided under the previous contract.

We believe that an entity should first determine whether the modification is in substance a new (i.e., separate) contract. If the modification is determined to be a new contract, such contract should be accounted for separately from the existing contract. The following indicators could be considered in evaluating whether a modification is a new contract:

- A separate purchasing decision has been made such as:
  - A master purchase agreement is modified to provide for the purchase of goods and services not initially included in the original agreement,
  - Additional goods or services are included but are priced at market rates.
- A significant price concession has not been provided for the new goods or services

If a modification (rather than a separate contract) exists, we believe the modification accounting should be based upon whether the modification affects either past or future services or goods. If the modification affects previously delivered goods or services, then the modification should be accounted for as a cumulative change in estimate. We believe that cumulative adjustments should generally occur only in limited situations. The following may indicate that a modification should be accounted for as a cumulative change in estimate:

- A price concession (either implicit or explicit) has been provided for previously transferred goods or services, such as:
  - A significant discount is provided on future goods or services compared to the selling price of those goods or services at the time of modification not consistent with market prices, or
  - Vendor agrees to refund consideration to which it was previously entitled.
• The parties agree to eliminate previously agreed-upon performance obligations from the contract, or
• Additional goods or services that are highly interrelated with the existing goods or services (e.g., design/ scope change orders on existing building construction) are included in the contract.

If the modification only affects future goods or services, it should be accounted for prospectively. The following may indicate that a modification should be accounted for on a prospective basis:

• Price for future goods or services in a pre-existing contract is reduced to align with current market prices,
• Price for future goods or services in a pre-existing contract is reduced in conjunction with customer agreement to purchase additional goods or services from the vendor not at a significant discount.

We believe revising the guidance as noted above provides an appropriate framework to evaluate modifications that better reflect the economics.

Question 2

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?

We generally agree with the proposed definition of a performance obligation and the concept of identifying separate performance obligations in a contract. However, the proposed principle for identifying distinct performance obligations when such obligations are not sold on a standalone basis may result in inconsistent application. Specifically, it is unclear why distinct risks and resources are relevant in determining whether a performance obligation should be accounted for separately. Distinct profit margin seems to imply both distinct revenues and distinct costs but the guidance only focuses on the resources (i.e., the costs) necessary to satisfy the performance obligation. We believe an example that illustrates a situation in which an entity is unable to identify the distinct resources although there are distinct risks and distinct function would be helpful to better understand why distinct resources are relevant.

We are confused, however, with the description of distinct provided in example 23 of the implementation guidance. That example concludes that product placement services provided by the customer would be a distinct performance obligation in addition to the sale of the product(s). We do not believe that product placement services by a customer for a product that the customer purchased from the vendor and now controls would be distinct from the purchase of the product. We believe the example contradicts the Boards' intentions with regards to identifying distinct performance obligations. We are also unclear why the distinct notion should be applied when evaluating goods or services received from the customer. The concepts for distinct were developed for purposes of considering the vendor's performance obligations and do not readily translate to activities performed by the customer. We would suggest retaining the terminology in existing guidance that focuses on whether an identifiable benefit has been received.

Question 3

Do you think that the proposed guidance in paragraphs 25-31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

As noted in our cover letter, we generally agree with the concept that revenue results from the satisfaction of performance obligations (i.e., when control transfers). However, additional clarification is needed to understand when control is transferred in service arrangements. We also believe that the guidance should explicitly maintain that control transfers in long-term construction, production-type or service contracts continuously as performance occurs.

Question 4

The boards propose that if the amount of consideration is variable, an entity should recognise 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 recognise 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 recognising revenue when the transaction price is variable and why?

We agree that revenue should be recognized using an estimated transaction price. However, as more fully described in our cover letter, we recommend that a probable and reasonably estimable threshold be applied to determine whether variable consideration should be included in the transaction price. Further, the use of a probability-weighted amount rather than a single best estimate does not always reflect the underlying economics in binary or other situations and presents operational difficulties. Disconnecting the underlying economics affects the user's ability to project cash flows and is not decision useful. We also believe additional guidance is needed to address subsequent event situations involving variable consideration.

We also suggest clarifying when variable costs (e.g., commissions) should be recognized. We believe that the principle for when variable consideration is recognized should also be applied to the related variable costs.

With respect to customer payments, it is unclear whether the ED intends to change current practice regarding when payments made to customers should be capitalized (e.g., slotting fees or "pay to play" payments). We do not believe the ED addresses this matter, which has been a long-standing practice issue. The Boards may want to consider providing further guidance for such situations. Current revenue literature also includes guidance regarding how to account for negative revenue when cash consideration given by a vendor to a customer is greater than the amount of cumulative revenue recognized. The proposed standard does not appear to address negative revenue situations. We believe this guidance is useful and recommend current U.S. GAAP guidance be incorporated into the final standard.

Question 5

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 recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why not?

As noted in our cover letter, we do not agree that customer credit risk should affect how much revenue is recognized by an entity. Because revenue is a key performance metric utilized by users of the financial statements, a high threshold should be considered when recognizing revenue. Revenue should not be recognized prior to contractual amounts being probable of collection.

Question 6

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?

As noted in our cover letter, we agree with the overall theory 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. However, we recommend providing a 12-month threshold (i.e., if a payment is received 12 months prior to, or subsequent to revenue being recognized) for applying this provision for practicality reasons.

If the current principle is retained, the Boards should provide additional guidance on how to apply the concept when the amount of consideration to be received is determinable, but the timing of settlement is uncertain. Would the time value of money be applied once the settlement date is known or should an estimated settlement date be determined? By using an estimated settlement date, an entity may be required to account for the time value of money regardless of whether the contract ultimately includes a material financing component.

Question 7

Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone 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?
We agree that stand-alone selling prices of goods or services underlying performance obligations should form the basis for allocating the transaction price. The principle is consistent with ASU 2009-13 and should be operational in most situations. Entities should be capable of separating a contract into distinct performance obligations and estimating stand-alone selling prices even if the items are not sold separately by the entity. The relative stand-alone selling price approach provides a reasonable basis for the allocation of the transaction price to the separate performance obligations and should best reflect the overall arrangement economics.

However, we note that estimating the stand-alone selling price for some performance obligations may be challenging particularly when pricing is highly variable (such as for software licenses). These challenges are beginning to be encountered as entities adopt ASU 2009-13. Accordingly, we believe that the residual method should be an acceptable allocation alternative. We believe this approach would alleviate the costs to apply the model while still providing decision-useful information.

Question 8

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, IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38 Intangible Assets or ASC Topic 985 on software), an entity should recognise an asset only if those costs meet specified criteria.

Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why not?

As noted in our cover letter, it is unclear how existing cost guidance (e.g., filmed entertainment, research and development, set-up costs, etc.) will be impacted by the proposed standard. We recommend the Boards separately expose the potential changes to existing cost guidance to ensure preparers and users of financial statements understand the potential impacts to existing guidance and whether any resulting changes would be operational.

While we agree with the Boards conclusion that costs to obtain a contract should be expensed, we are unclear why this conclusion is different from the Boards current position in the exposure drafts (or discussion paper) on the accounting for leases and insurance contracts as selling costs may be capitalized/deferred under those proposals. We believe the Boards should consider reconciling these differences as conceptually they do not seem to warrant different treatment.

Additionally, it is unclear how to account for costs incurred prior to contract terms being finalized. We can envision a scenario in which the vendor may begin design, setup or similar activities prior to a contract being finalized with a customer. We believe costs incurred prior to contractual terms being finalized should be capitalized assuming they meet the criteria in paragraph 57 of the ED and relate to a specific contract currently under negotiation. We do not believe the proposed guidance is meant to imply that future contemplated contracts can be considered in applying this guidance; however, we are concerned that the ED is not clear on this point.

Question 9

Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

We generally agree with the definition of costs for purposes of recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract. However, we are concerned that the reporting of some contracts may not represent the underlying economics. An example is a production-type contract for highly customized equipment where significant costs will be incurred in developing the initial equipment and those costs are incorporated into the pricing for future purchases of the equipment under that contract. We believe the costs incurred in developing the initial equipment will clearly benefit future production for that contract and should be capitalized and then recognized as cost of sales as future production occurs. We note that this accounting has been long-standing practice and we believe has generally been viewed as better reflecting the underlying contract economics.
Although we agree with the inclusion of an onerous test, we have some concerns with the application of the onerous test as currently structured because the assessment may not always reflect the contract economics. In general, we believe the onerous test is performed at too low of a level and the assessment should only include direct and incremental costs of fulfilling the obligation rather than all direct costs. We believe the following examples illustrate our concern:

- **Airline tickets** - An airline prices individual seats (i.e., contracts) based on the goal of filling the plane during each flight. The airline is trying to achieve an overall revenue goal per plane but is not focused on profitability of any particular seat. If the costs to fly the plane are allocated to the individual seats, an onerous performance obligation might result for some seat contracts although the overall flight is profitable. This would seem to result in the recognition of a loss in advance of the related revenue being recognized which does not appear appropriate.

- **Loyalty programs** - A credit card company that also offers its customers a loyalty program. The loyalty program may not be profitable when evaluated in the context of expected revenue from the cardholder perspective. However, the arrangement is profitable overall when transaction fees received from third parties (i.e., merchants) are considered. It is unclear to us whether the revenue from other customers should be considered when applying this test.

- **Variable consideration** - If the entity is able to determine the costs to satisfy the separate performance obligations at contract inception but is unable to reasonably estimate the amount of consideration to be received, would a loss be recorded at contract inception (because the transaction price is zero for determining revenue recognition)?

We also believe additional clarity is needed regarding whether the discount rate needs to be continuously updated once an onerous performance obligation exists.

**Question 10**

*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?*

We are not convinced that the proposed disclosure requirements will significantly enhance a user's ability to understand the amount, timing and uncertainty of revenue and related cash flows such that the costs to provide the information outweigh the perceived benefits. From a cost perspective, we are particularly concerned with the rollforward disclosures and “future maturity” schedule described in paragraphs 75-76, and 78-80 of the ED. Systems are generally not configured to capture this information and significant costs could be incurred to comply with the requirement, particularly in decentralized environments or when many systems exist within an organization. We also note that the Boards are proposing similar rollforward requirements in the financial statement presentation project. We believe that any rollforward requirements should be addressed in one project rather than on a piecemeal basis. Lastly, we note that the FASB currently has a disclosure framework project on its agenda that is examining the objectives and extent of disclosures on a more holistic basis. We believe a more comprehensive approach to disclosure should be finalized prior to significantly expanding disclosures and requiring companies to incur the costs to comply with those requirements.

We also believe that the general disclosure requirements are ambiguous or generic and will likely be interpreted differently in practice. Additional illustrative examples would be helpful to understand the boards’ vision as to how compliance with those requirements might be achieved.

**Question 11**

*The boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year. Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?*

We do not agree that an entity should be required to disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year. We do not
believe further disaggregation will provide financial statement users with reliable, decision useful information if management does not use this information to manage its business. This disclosure may be difficult to audit (as it is based on projections rather than contractual requirements) and will be costly to prepare if a company does not track this information for internal purposes.

Question 12

Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

We agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors. We believe that this information is generally available and in many cases, provided to users in means other than the financial statements. We would encourage the Boards to clarify that multiple categories of revenues (e.g., by product, region, etc.) might be necessary to comply with this proposal objective as some might interpret the guidance to require only the category that best depicts the objective.

Question 13

Do you agree that an entity should apply the proposed requirements retrospectively (i.e., as if the entity had always applied the proposed requirements 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’s better.

As noted in our cover letter, we are concerned that it will be impracticable to objectively determine and/or costly to apply the effects of the change in accounting principle retrospectively in many cases. If retrospective application is to be required, we believe significant aspects of the ED would need to be revised or special transition guidance would be needed to address these situations. Examples include when there are significant long-term contracts, significant variable consideration, or other items which require a significant degree of historical estimation. Therefore, we believe prospective adoption should also be permitted, supplemented with reasonable transition disclosure.

Question 14

The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

We commend the Boards for including the implementation guidance in the standard. The proposed application guidance provides useful insight into applying the principles in the proposed standard and is helpful in making the proposed concepts operational. We believe application guidance should be included in the final standard and should be robustly field tested across many industries. Such field testing is critical in determining where additional guidance is necessary. We also note that many of the fact patterns in the ED are rather simplistic. We believe additional guidance would be particularly helpful if provided for more complex fact patterns. Specific areas that we would suggest providing additional application guidance include:

- A biotech contract including collaborative arrangement payments, research, milestone payments, etc. This would help illustrate multiple aspects of the model including allocating variable consideration when changes occur and evaluating whether payments within a contract would be considered payments to a customer. We believe this is an area that existing guidance could be improved upon as there is diversity in practice.
- A construction contract change order (a modification and non-modification) since change orders are so prevalent within those contracts.
- Expanded disclosure examples to illustrate the level of transparency requested
- Application of time value of money for a multiple element arrangement and a contract where control transfers continuously
- Consideration of separate performance obligations when a distinct profit margin does not exist

We also note that Example 18, Management fees based on an index, is not helpful because it is not representative of most transactions in the asset management industry. The fee structure in this industry is generally entirely variable at
contract inception. The management fee is generally structured as a percentage of net assets under management for each period (which is determined as frequently as daily). We are concerned that unless an entity can assert that the management fee for the entire year is reasonably estimable (which may be difficult given the correlation to market movements), revenue recognition would not reflect the economics of the transaction. That is, revenue would be back loaded because the transaction price would be limited to the amount of consideration that becomes fixed each period. That amount would then need to be spread over the future periods of service. We note that similar accounting could also result in royalty situations for intellectual property when future royalties are determined to not be reasonably estimable. We believe that the variable consideration model should be flexible to address such situations; that is, if the substance of the variable consideration is clearly related to past performance and other payment terms in the arrangement are reasonable, then the variable consideration should be recognized in its entirety in the period that performance occurs and the fee becomes fixed or determinable.

We also believe additional guidance is needed to clarify the accounting for payments made to customers (e.g., slotting fees) and variable consideration.

Question 15

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?

We do not believe that the proposed model should distinguish between a warranty that provides a customer with coverage for latent defects and coverage for defects that arise after the product is transferred. We believe that in many cases the warranty obligation cannot be meaningfully separated and that current guidance should be retained for accounting for warranties - that is, the cost accrual method should continue to be applied to standard warranties and the performance obligation model should continue to be applied to extended warranties. Current guidance is understood in practice and is applied consistently across industries. In addition, we do not believe that this topic is one that is of significant concern to users to warrant a change in application.

However, if the current model for accounting for standard warranties (i.e., warranties that are included with a product sale) is not retained, we believe that all warranty obligations should be accounted for as a performance obligation. The proposed model which distinguishes between coverage for latent defects or insurance for defects arising through the normal use of the product is not operational and will not provide the users of the financial statements with decision useful information. It will be difficult for companies to bifurcate the warranty when it covers both latent defects and defects arising through normal use of the product.

If the Boards decide to retain the dual-warranty approach, we believe the failed sale model should only apply when the entire product is being replaced (i.e. it would not apply to component or parts replacements). We believe this is consistent with the accounting for returns because the entity is taking the original product back. This modification would make the dual-approach more operational.

Question 16

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 licence; and

(b) if an entity grants a customer a non-exclusive 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 licence.
Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the pattern of revenue recognition proposed by the boards? Why or why not?

As more fully described in our cover letter, we believe the proposed model for the license of intellectual property does not reflect the underlying economics of the transaction and is inconsistent with the performance obligation model outlined in the ED. The timing of recognition should be based on the transfer of control of the license and whether the licensor has satisfied its performance obligation. If the Boards retain the exclusivity notion, we believe additional guidance would be helpful to understand how that assessment should be made in more complicated fact patterns to illustrate the unit of account.

We also suggest the Boards describe their rationale for any differences between the license model in the revenue standard and the lease model. Under the proposed lease standard, a net lease asset or liability will be presented which represents the net amount of the right to receive lease payments, the leased asset and the performance obligation. Although presented net, each of those amounts will be shown separately. It is unclear under the ED whether those items would be presented in a similar manner for licenses accounted for using the performance obligation approach. We believe the Boards should provide further clarification regarding the presentation in such a situation.

Question 17

The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

We agree that the principles included in the proposed standard should be applied to a sale of non-financial assets that are not part of an entity’s ordinary activities. The proposed standard provides a reasonable model for recognizing the gain or loss on the sale of non-financial assets and will increase consistency in financial statements. However, we believe further clarification should be provided regarding whether the following guidance will be revised:

- Oil and gas conveyances (Subtopic 932-360),
- Deconsolidation exceptions for in-substance real estate and oil and gas conveyances (Subtopic 810-10), and
- Gas balancing transactions (Subtopic 932-10).

Question 18

[FASB only] Should any of the proposed requirements be different for non-public entities (private companies and not-for-profit organisations)? If so, which requirement(s) and why?

We believe that the proposed standard should apply to all entities that enter into contracts with customers. Allowing non-public entities to apply a different revenue standard(s) will not increase consistency among entities and will further divide the public and private markets. However, the extent of the disclosure requirements should be considered as the increased disclosure may not provide decision useful information for the reader of the financial statements (i.e., financial statements may not be widely distributed or may be generated for internal purposes only).