DIRECTV appreciates the opportunity to comment on the Exposure Draft of proposed Accounting Standards Update, Revenue from Contracts with Customers (the "ED").

DIRECTV distributes digital entertainment programming via satellite to over 25 million residential and commercial subscribers in the United States and Latin America.

We commend the Financial Accounting Standards Board (the “FASB”) and the International Accounting Standards Board ("IASB", collectively the "Boards") for developing a converged model for revenue recognition and agree with the Boards’ objectives described in the ED. However, without additional clarification and refinement, we believe that the proposed model could be interpreted in such a manner as to create significant accounting and system complexity without providing users with a significant improvement in information about our reported revenue. In particular, the ED, in conjunction with the proposed standard on leasing activities, may be interpreted to require a continuous re-assessment of accrued revenues for each of our over 25 million subscribers for variables such as routine programming package changes, changes to the number of receivers provided, and even changes to estimated subscriber lives. Our subscriber base consists of a large number of subscribers with similar monthly fees, and therefore changes in revenue recognition at the individual contract level would, over time, result in no significant change in the overall amount of reported revenue from period to period. Accordingly, the standard has the potential to add significant complexity to our accounting for revenue at a prohibitive cost with no meaningful improvement to the quality of our reported financial results for users.

In summary, we believe that the following clarifications or revisions would help to ensure the operability of the standard, simplify application, add clarity and certainty to the recording of revenue, and limit potential abuse:

- Improve the definition of a “distinct” performance obligation.
- Reconsider the interaction of this ED with the Exposure Draft of proposed Accounting Standards Update for Leases (the "Lease ED").
- Limit performance obligations for customer options for additional goods and services to only those instances where the entity is obligated to provide incremental services at a discount.
• Clarify the definition of “transaction price” to include only consideration to be received from the minimum contractual commitment.
• Refine contract modification guidance.
• Record adjustments to credit risk estimate in revenues.
• Permit, rather than require deferral of contract fulfillment costs.
• Provide additional guidance for the determination of stand-alone selling prices.
• Revise principal vs. agent guidance to allow revenue recognition where intermediary offsets exist.
• Change the basis of recognition of onerous performance obligations.

Each of these points is discussed in more detail below.

Improve the definition of “distinct” performance obligations

The definition of a distinct performance obligation should be refined to avoid potential situations where the determination of distinct performance obligations could be based on unusual or infrequent transactions performed by third parties. The ED defines one aspect of “distinct” as: “the entity, or another entity, sells an identical or similar good or service...” This constricts an entity’s revenue recognition to another entity’s practice; thereby requiring revenue recognition on a product or service regardless of whether the customer or the reporting entity would view the item as a transfer of a promised good or service to the customer.

For example, it appears that the definition in the ED would require us to consider installation services provided at contract inception as a separate performance obligation because there are third parties, such as home theatre specialists, who install our equipment for a small number of subscribers at the subscribers’ expense. Practically speaking, very few subscribers would seek a third party installer because we typically provide installation free of charge and don’t provide a discount to those who install on their own. More importantly, we don’t perceive installation to be a revenue generating activity, but rather a cost to obtain a paying subscriber or to build out an incremental portion of our broadcast system.

For further illustration, assume we sell our receivers to subscribers. Under the proposed definition of distinct, it appears that the sale of receivers would be considered a separate performance obligation because another entity could sell a cable/satellite/internet television receiver separately. Similar to installation, we generally don’t view the mere delivery of our unique equipment which has no utility apart from our service, as a revenue generating activity/satisfaction of a performance obligation.
Therefore it would be helpful if “distinct” was defined more clearly. Distinct performance obligations could be refined to exclude goods or services which by their nature may be considered costs incurred to fulfill a contract as discussed in paragraph 57 of the ED. This would allow an entity to conclude, for example, that equipment and installation/set-up services transferred free of charge at inception of a contract are not performance obligations.

Alternatively, the definition of distinct could also be improved by eliminating the words “or another entity” or providing a narrow definition of “another entity”. For example, “another entity” could be limited to only those entities that are rational alternatives to the reporting entity for most of its customers. Rational alternatives could be limited to those providers which do not come with an economic disincentive to the customer, or whose equipment is otherwise compatible/usable with the other performance obligations in the arrangement.

Finally, we note that current US accounting standards minimize this issue by limiting revenue recognition at inception of an arrangement to the amount of consideration not contingent on providing additional services. We believe this continues to provide more useful information to users as it more clearly reflects our business model. Alternatively, International Financial Reporting Standards (IFRS) limit the determination of separate performance obligations based on whether an element has stand alone value to the consumer. Consumers do not see a stand-alone value in our installation or equipment, and therefore we view this as a rational limitation of the definition of distinct.

**Reconsider the interaction of this ED with the Lease ED**

The definition of “distinct” in the Lease ED may result in a conclusion that all revenues in our contractual arrangements be reported as a lease.

We intend to provide separate comments on the Lease ED, but it is worth noting here that because we provide equipment to subscribers for a monthly charge, we could determine that the arrangements contain a lease and that we would be required to apply paragraphs B5 to B8 of the Lease ED to determine whether our contracts contain a distinct service element to be treated separate from the lease. In the Lease ED definition of “distinct”, the problematic term is the word “separately” in paragraph B7(a). We generally do not provide our service without providing our unique equipment. Others offer similar services, but only through their own unique equipment. Therefore, the service cannot be provided “separately”. Alternatively, the Lease ED provides that a service element is distinct if it has utility on its own or together with other non-leased goods or services provided to the lessee and it has a distinct profit margin. Again, in our view the service has no utility without the leased equipment regardless of whether the profit margin is distinct.
As a result of these facts, we are concerned that one might conclude that the entire arrangement is a lease pursuant to paragraph B5(b) of the Lease ED. We do not believe that this conclusion faithfully represents the underlying economics of the arrangement, as the equipment is merely a conduit to providing the product our subscribers are really purchasing – programming.

Indeed, even if the definition of distinct were further relaxed in the Lease ED so that the service was deemed distinct, the resulting outcome, where payments need to be allocated to the separate lease and service performance obligations based on standalone selling prices, is not operable. Paragraph 35 of the ED provides a measurement of the transaction price based on “the probability weighted amount of consideration that an entity expects to receive.” The Lease ED requires an analysis of “longest possible term that is more likely than not to occur” in order to determine the lease term and the present value of lease payments. It is not clear whether the intent would be for these periods to coincide or be different. This guidance presents additional application complexity, because many service providers charge a flat fee for equipment which is not based on the relative cost of various receivers offered (HD, DVR, etc.). Accordingly, entities would have to estimate a sale or monthly lease price regardless of whether they are in the business of either selling or leasing equipment separate from a service.

In our opinion, the definition of a lease should be modified to provide a more operational methodology for service companies such as DIRECTV to clearly conclude that similar equipment be excluded from the leasing standard. For example, the standards could allow that specialized equipment with no material independent utility from a service provided by the service provider for use in delivery of the service need not be considered a lease for purposes of the application of the two standards. Alternatively, the definition of distinct could be focused on whether the equipment is distinct from the service. Reporting entities would then be able to consider whether such assets are fixed assets, or perhaps other contractual costs subject to deferral under paragraphs 57 to 63 of the ED.

**Limit performance obligations for contract renewal options**

While we agree with the concept that a material right for additional goods and services should be considered a separate performance obligation, the guidance regarding identification of options to acquire additional goods and services in paragraphs IG24 to IG26 should be modified so that contract renewal options are a material right and a separate performance obligation only if the renewal would be at preferential or discounted pricing.

In our industry, subscribers are typically on month-to-month arrangements following a minimum commitment period at current prevailing prices. Subscription television service providers typically do not provide the subsequent month-to-month services at any discount, and additional services to be provided after the minimum commitment are not conceptually or economically different from additional services, such as pay-per-view movies, which a subscriber may purchase during the initial contract period.
Paragraphs IG 27-28 provide that an up-front fee should be amortized over a period longer than the initial contractual period if the company grants a renewal option and that option provides the customer with a material right. In general, an option to renew at prevailing rates at the time of renewal should not be considered a "material right", and therefore the conclusion in the example regarding health club membership fees that the up-front fee should be amortized over the estimated customer life should be revised. In fact, the conclusion in the health club example is economically inconsistent with the telecommunications example. The health club example inherently concludes that there is a performance obligation for add on services at normal rates (additional club access purchased at the option of the customer), while the telecommunications example concludes there is not a performance obligation for add-on services at normal rates (additional minutes purchased at the option of the customer).

We believe the interpretation in the telecommunications example is the more appropriate conclusion for both circumstances; add-on services during or after the contract period available at normal rates do not represent a material right and therefore do not represent a separate performance obligation. We also note that with the cumulative catch up modification model in the ED, companies could manipulate revenues from up-front fees each reporting period merely by revising estimates of how long customers are expected to purchase goods or services. Therefore, limiting amortization to the minimum contractual commitment would limit an opportunity for abuse.

If the Boards believe there are instances where upfront fees should be amortized past the minimum contractual commitment because they imply a material obligation/right even though there is no future discount, additional guidance should be provided to make that determination. For example, that conclusion could be based on whether an up-front fee is deemed to be so significant that it would be viewed by the customer as an incentive to renew or inherently implies that all future goods or services are provided at a discount. We and other service providers often charge up-front fees, however these fees are typically immaterial in relation to the overall customer relationship, and it is clear from the dynamics in our industry that up-front fees do not represent an incentive for a subscriber to remain connected.

Clarify the definition of “transaction price”

The ED requires the estimation of the transaction price as the “probability-weighted amount of consideration that an entity expects to receive from the customer in exchange for transferring goods and services”. This definition, together with other explanatory language in the ED, is open to the interpretation that the contract and transaction price are broadly defined to include all possible goods and services to be provided to a customer.

We strongly believe that the final standard should be refined to clearly define the transaction price to include only the amount of consideration to be received for the minimum contractual commitment (promise) for goods and services.
In order to provide examples as to why this is important, we provide the following assumptions:

- Subscribers are typically required to commit to a minimum programming package for 12 to 24 months.
- Subscribers are only required to purchase a minimum base programming package and, at the conclusion of the commitment period, have the option to continue receiving services month-to-month based on current prices.
- Subscribers have the option to purchase additional receivers and addition services, such as pay-per-view movies or premium movie channel subscriptions. These are provided at the same undiscounted rates to all subscribers.
- There is no separate contractual right or performance obligation resulting from an option to purchase additional add-on services or renew at a discount.

Paragraph IG 26 of the ED, including the example of incremental minutes provided under a telecommunications contract, implies that optional at-will purchases at normal prices, such as the pay-per-view movies we offer to subscribers, should be excluded from the performance obligation/transaction price definitions. We believe the same conclusion should be reached for services that we can reasonably expect to sell on a continuous basis to some subscribers, such as premium movie channel subscriptions which can be added or cancelled at any time by the subscriber, or standard services subsequent to the minimum contract period. All of these at-will, add-on services should be excluded from the determination of the transaction price because there is no mutual promise to provide or purchase these services.

We also believe that the final standard should be refined to exclude optional purchases or extension periods from the determination of the transaction price because their inclusion would create an opportunity for the manipulation of the amount of revenue recognized in a given period.

For example, a hypothetical subscriber could sign up for a two year commitment and receive free service for 5 months. At inception, an entity might estimate that the customer, on average, would remain connected for 5 years. This pool of revenue would be allocated, and a certain amount recognized during the free period. If at a later date, the entity changes that estimate to 6 years, then it would have to re-allocate revenue over the 6 year period. The re-allocation of revenue required by the ED would result in the ability to do a revenue “catch up” for the free period, by changing the estimated subscriber life. In effect, changing the estimated subscriber life would result in an immediate accrual of revenue, effectively pulled forward from a period during which the subscriber has no obligation to remain a customer. Similarly, estimates of add-on services both during the minimum commitment period and subsequent periods would be wide open to abuse. Entities could manipulate recorded revenues by managing these estimates.
Finally, if the intent of the definition is indeed to include add-on and post minimum contract period services, the complexity of estimating which services a given subscriber may take and for what period would be nearly impossible to efficiently manage for our over 25 million subscribers. In addition, as subscribers change the services that are provided, the modification accounting could add an additional layer of re-calculation of revenue for each subscriber that would be administratively impossible to maintain. This complexity would make the standard completely inoperable for telecommunications service providers such as DIRECTV.

Accordingly, the final standard should clearly state that the transaction price is based on the minimum goods and services required/promised to be provided/purchased under a contract over the minimum term. By using this definition, in instances where the customer is granted a material right in the form of an option to purchase additional goods and services at preferential prices, a portion of the transaction price would be allocated to that performance obligation and recognized as those incremental goods or services are purchased, whether during or subsequent to the initial contract period.

**Refine contract modification guidance**

The ED provides for retroactive adjustment to cumulative revenues at the time of a modification of a contract when the prices in the modification are interdependent with the existing contract. It is not clear whether the typical modifications to our contracts are interdependent as described in paragraph 13 of the ED, and it appears that they are interdependent if we apply paragraph 15 of the ED. If the intent is that the definition of “independent” in paragraph 15 of the ED is relevant to segmentation only, and should not be considered when determining whether to combine a contract modification, that point should be clarified. However, in general we believe the definition of interdependent should be refined so that our contract modifications are not universally considered interdependent.

Our contract modifications typically are in the form of additional services for free, promotional credits offered to incentivize a customer to remain connected, or an incremental contractual commitment (additional months of service) in exchange for providing additional equipment. We don’t view these activities as a modification of the original contract, but either as a marketing tool (retention) or as an additional contract for incremental services prospectively. Economically, we do not view incremental services added or removed from time to time by subscribers as a re-negotiation of the overall contractual arrangement, and indeed incremental services often include products that were not even available when the subscriber originally joined.

In addition to our view that these changes should not result in a retroactive re-allocation from an economic perspective, we note that this model may be subject to abuse. Service providers could manufacture revenue in a period just by adding incremental services, such as providing premium movie channels for free for three months, regardless of whether the customer wanted that service.
We also note that the system and personnel cost to track such changes for each of our over 25 million subscribers would be prohibitive and in effect make the ED inoperative.

Accordingly, the modification guidance should be revised to allow for a conclusion that additional goods or services provided to consumers are not interdependent with the original contact when such goods or services could be considered a marketing offer, represent services that were not available at contract inception, or are otherwise provided as part of a common business practice.

**Record adjustments to credit risk estimate in revenues**

Given the significant number of estimates created by the revenue recognition model in the ED, it is not intuitive that adjustments to the credit risk estimate alone should be booked outside of revenue in a unique treatment from other estimates. This requirement provides an incentive for abuse, whereby an entity would seek to minimize the estimate at inception of an arrangement because subsequent adjustments would be booked elsewhere. Accordingly, subsequent adjustments to the credit risk estimate should be recorded in revenue. Alternatively, the final standard could retain the existing practice where bad debt expense is recorded outside of revenues.

**Permit, rather than require, deferral of contract fulfillment costs**

The final standard should permit, rather than require, the deferral of contract fulfillment costs. We typically expense such costs because 1) deferral results in reduced transparency due to a complicated mismatch of revenues and expenses under the contract, and 2) we don’t view these costs as substantially different from the costs of obtaining a contract (i.e. costs described in paragraph 59(a) in the ED). If we were to defer these costs (mostly installation and related costs), we would possibly end up with a partial expense/partial deferral model because the anticipated margins over the minimum contractual commitment may be less than the amount of contractual costs we may incur. In addition, the deferral period is inconsistent with the expected period of economic benefit because deferral would (and should) be limited to the minimum contractual period, despite the fact that we expect most subscribers to remain customers for a period significantly in excess of the minimum commitment.

Therefore, we would report partial up-front expense and partial amortization over a period that is inconsistent with the anticipated period of economic benefit under the arrangement. In addition, the deferred asset is subject to continuous impairment analysis and periodic impairment charges which further complicate the accounting. In summary, this complicated accounting will not provide the most relevant and understandable reporting of our financial position or operating results, and therefore an option to expense these costs is required.
Provide additional guidance for the determination of stand-alone selling prices

In the event that the Boards do not further refine the definition of “distinct” in both ED and the Lease ED, as discussed above, the final standard should provide additional guidance regarding the determination of standalone selling prices in instances where equipment and services are not sold separately. For example, should entities assume an average margin for all performance obligations in an arrangement when they have no experience selling the components separately? As noted above, we typically do not sell our equipment. Our equipment is unique to DIRECTV, can only be used by a DIRECTV subscriber, and we have no internal knowledge of how a third party would price the equipment if there were actually a market to sell the equipment on a stand-alone basis. Absent further guidance, this measurement is open to easy manipulation by reporting entities.

Add a provision in the principal vs. agent guidance to allow gross revenue recognition where intermediary offsets exist

The final standard should provide additional application guidance that would clarify the accounting where cash offsets from intermediary parties are included in the transaction price with the customer. For example, assume we charge fees to subscribers at inception of a contract. If the subscriber is obtained directly by DIRECTV (e.g. through our own web-site), that fee would be considered revenue to DIRECTV. That same fee would also be charged to subscribers by independent dealers/retailers who sign up DIRECTV subscribers on behalf of DIRECTV. In those cases, assume the dealer would not remit the amount collected to DIRECTV, but rather the commission paid to the dealer is reduced (revenue collected by the dealer is offset against commissions owed to the dealer). Since these fees are economically similar from the perspective of DIRECTV and the subscriber, we believe we should obtain economically similar accounting and treat the amount as part of the transaction price/revenue regardless of who collects the cash. In other words, we would record the transaction with the dealer on a gross basis instead of net.
Change the basis of recognition of onerous performance obligations

The measurement of an onerous performance obligation should be based on the overall contractual arrangement with a customer. Because the transaction price is allocated based on standalone selling prices, and because individual performance obligations could have substantially different standalone profit margins, we can foresee circumstances where an individual performance obligation would be considered “onerous” once the implied bundled discount of the arrangement is allocated to the individual elements, despite the fact that the overall arrangement is profitable. The measurement should be based on the contract in total and/or the onerous amount should be allocated as a contract fulfillment cost to the other performance obligations in the contractual arrangement. In certain circumstances, it may also be appropriate to consider add-on services outside of the contractual arrangement where an entity can reasonably demonstrate that customers will purchase incremental services during the contract period at margins that will allow the entity to recover a “loss-leading” element in the overall relationship with the customer.

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In addition to our comments above, we have also provided specific responses to some of the questions posed by the FASB in the attached appendix.

Again, we appreciate the opportunity to comment on the ED. If you have any questions regarding our comments, please feel free to contact John Murphy at 310-964-0714 or Steve Adams at 310-964-0807.

Sincerely,

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Appendix – Responses to Selected Questions

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 do not agree with the principle for determining when a good or service is distinct as discussed in our letter above.

Question 4: 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?

As noted in our letter, we believe the transaction price should be defined to be limited to the minimum obligation/promise under the contract. Revenues recognized for transferred goods and services in excess of the minimum contractual amount should be net of adjustments, both positive and negative, for a performance obligation to provide additional goods and services at a discount.

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?

In general we agree with this concept. However, we don’t believe that our customer arrangements contain a financing element, and the guidance should be more specific regarding this determination. For example, implementation guidance could provide that in the case of contracts to provide telecommunications services over time, discounted services over a portion of a minimum service period are often more appropriately considered a marketing offer rather than a financing arrangement. Alternatively, there could be a rebuttable presumption that service arrangements typically do not include a financing element.

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 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?
While we agree in concept with the allocation of transaction price to all separate performance obligations in a contract in proportion to the standalone selling price, the determination of stand-alone selling prices is speculative and subject to manipulation when an entity does not actually sell unique goods and services on a stand-alone basis. This issue would be partially resolved if, as discussed in our letter, the definition of “distinct” is refined to limit the circumstances where an item is distinct merely because another entity can sell it. Alternatively, as noted in the letter, additional guidance is necessary to determine stand-alone selling prices.

**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, 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?

We agree with this concept. However, as noted in our letter we don’t view these costs as economically different from the costs to obtain a contract, and because we would be limited to a partial deferral of these costs in many circumstances, we would prefer to have the option to expense these costs as incurred. We believe this presentation is more straightforward to understand.

**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 agree with that disclosure requirement. However, it is not clear whether the Boards intend contractual assets and liabilities to be carried in separate current and non-current accounts. If so, then that presentation may be sufficient for many entities.

**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 don’t believe this is necessary, as these uncertainties are already addressed via the standards on concentration of credit risk.

**Question 14:** 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?

See our comments in our letter regarding various suggested changes to the implementation guidance.