November 1, 2010

Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116, USA

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

Re: Exposure Draft Revenue from Contracts with Customers

Dear Sir/Madam:

We appreciate the opportunity to comment on the exposure draft *Revenue from Contracts with Customers*. Our responses to the specific questions are attached in the appendix to this letter.

We support a joint project to clarify the principles of recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS. We believe adopting a single revenue recognition standard will enhance comparability and consistency among preparers of financial statements and hence provide more decision useful information to the financial statement users.

We generally agree with the proposed standard, however, there are multiple areas which require revision or further clarification as explained in our responses in the appendix. We have one major point of disagreement pertaining to the scope of this standard. We do not believe the proposed standard will increase the usefulness of the financial statements for entities in the commercial construction industry. Instead, it will likely create an unnecessary burden for the preparers. The current method of recognizing revenue based on incurred cost and percentage of completion provides the users of financial statements with information relevant for useful decision making. Therefore, we propose that the Boards consider excluding the construction contracts from the scope of this standard.

Sincerely,

Clinton M. Holsinger
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LaTasha R. Rush
Liren Yuan
Appendix. Responses to Exposure Draft Questions

Recognition of revenue (paragraphs 8–33)

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 conceptually agree with the proposed principle for determining whether to combine or segment contracts. We believe, however, the Boards should broaden the price interdependence principle to include all economically interdependent contracts. In addition, the Boards needs to explain the intended meaning of paragraph 14, which appears to contradict paragraph 13, in order to avoid the lack of comparability between the entities with similar revenue.

We agree with the Boards on the need for a segmentation principle to (a) simplify the assessment of scope and (b) determine the promised goods or services to which an entity should allocate proportions of the transaction price.

We believe there is a need for additional clarification regarding the different types of contract modifications. This will allow preparers to fully understand when to apply a cumulative effect vs. prospective accounting treatment. Otherwise, we could end up with inconsistent accounting for contract modifications which will not properly reflect the economic reality. For instance, one of the indicators outlined in paragraph 13 requires that the contracts are entered into at or near the same time. If we were to strictly follow this indicator, then most contract modifications would represent new arrangements since they usually happen at a later date.

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 agree with the concept of distinct goods or services based on function for identifying separate performance obligations. We believe the concept of distinct profit margin should be removed or further explained. We point to the example listed in the comment letter from Ernst & Young (Comment letter #419), which states an entity may conclude that a software license is not distinct from post-contract customer support in situations where the entity uses the same resources to develop the underlying code, which would seem
contrary to the underlying economics of the transaction. As this example shows, some clearly distinct performance obligations (i.e., software license vs. post-contract customer support) might not have a distinct profit margin since they use the same resources.

Question 3: Do you think that the proposed guidance in paragraphs 25-31 and related implementation 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?

We generally agree with the revenue being recognized with the transfer of control. Nevertheless, the control model does not work well in all circumstances (i.e., construction contracts). It appears the Boards recognize this fact by allowing for the continuous transfer of control. However, we believe without more specific and clearer guidance, the current proposal will likely reduce the usefulness of the financial statements for entities in the commercial construction industry. Therefore, we propose the Boards consider excluding the construction industry from the scope of this standard. The current method of recognizing revenue based on incurred cost and percentage of completion provides the users of financial statements with information relevant in decision making.

Measurement of revenue (paragraphs 34–53)

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?

We agree an entity should recognize revenue on the basis of an estimated transaction price, and we believe the guidance in paragraph 38 is appropriate. We are, however, concerned the measurement of revenue based on probability-weighted estimates could increase the level of uncertainty for decision makers. In the case of transactions with two possible outcomes, the probability-weighted method is not useful. This approach could lead to the recognition of the revenue the entity does not believe it is likely to collect, and vice versa. This proposed standard will require a high level of judgment and impose a costly compliance burden on preparers and auditors. Instead, we support the use of best estimate when recognizing revenue.

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 recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue? If not, why?
We understand many users would like to see the effects of customer credit risk separately from the transaction price for the analytical purposes. However, we do not believe subsequent changes in estimates of collectability should be recorded in other income or expense. Separating initial measurements from subsequent measurements will not provide users with decision useful information. Therefore, we believe subsequent changes should continue to be recorded as additional revenue or bad debt expense.

The Boards need to provide more guidance pertaining to what to do when entity cannot reasonably estimate customer’s credit risk.

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?

While we agree with the proposed guidance, we believe the guidance on time value should apply only to material transactions where payment of cash is expected to be received more than one year after the transfer of control of the good or service. If this is the Boards’ intent, this point should be clarified in the final statement.

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?

We agree the transaction price should be allocated to separate performance obligations in a contract in proportion to the standalone selling price. We believe this is the best way to get the operating margins for each performance obligation to properly reflect the underlying economics of transaction.

We understand allocating the transaction price to separate performance obligations may prove difficult and costly for some entities with large numbers of customers on the individual contract level; therefore, the Boards should not require allocation in situations where it is impractical.

Contract costs (paragraphs 57–63)

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?

See response for questions 8 & 9 under question 9 below.
Question 9: Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation.

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

We believe the guidance regarding the capitalization of costs should not be part of a revenue standard. We would prefer all cost guidance to be dealt with separately with an end goal to produce a common, single standard regarding costs. This course of action would prevent a situation where cost guidance in this standard might be in disagreement with the cost guidance included in other, existing standards.

If the Boards decide to keep this cost guidance in the final standard, we believe there is more clarification needed for the long-term contracts. For instance, can an entity which enters into a long-term production contract use the average unit cost for purposes of recognizing an asset? In addition, we believe in some cases the costs of obtaining a contract, if allowed to be capitalized, would better represent the underlying economics of some transactions. For instance, some sales commission cost should be treated as an asset. The accounting rules for such costs should be similar to the deferral of acquisition cost in an insurance contract.

Disclosure (paragraphs 69–83)

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 believe the proposed disclosure requirements will not meet the Boards’ objective and will not improve disclosures. The proposed disclosures are onerous and excessive. We are concerned the useful information may be hidden by the volume of information required to be disclosed.

We agree with PricewaterhouseCoopers (Comment letter #190), that the proposed disclosure requirements “appear to duplicate information already required under existing standards.” Paragraph 74 may duplicate segment-reporting standards. We are also concerned this proposal will not necessarily provide useful information to users of financial statements, and the cost may outweigh the benefits.

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 disagree with the proposal to disclose the amount of remaining performance obligations as well as the expected timing of the satisfaction for contracts with an original duration greater than one year. We acknowledge the proposed, additional information may prove to be relevant in predicting future revenues and future cash-flows; however, the information may not be decision-useful. We are concerned with the level of detail which may be required. It could be impractical to determine the expected timing of satisfaction of performance obligations if it is not already available. Another concern is whether the expense will outweigh the benefit with this initiative. We, therefore, believe this should be an optional disclosure, rather than a required disclosure.

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 an entity should disaggregate revenue into the categories which best depict the amount, timing, and uncertainty of revenue and cash flows which are affected by economic factors. In order to avoid adding additional cost, the Boards should specify such disaggregation be based on the entity’s method used to manage the business.

Effective date and transition (paragraphs 84 and 85)

Question 13: Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

We agree with the Boards’ full retrospective application of the proposed guidance. The retrospective method improves the understandability and comparability of financial information across different periods, even though the retrospective application is likely to be more time-consuming and expensive to many entities. This problem may be mitigated by providing a sufficient lead-time to help entities apply the standard retrospectively.

Implementation guidance (paragraphs IG1–IG96)

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?

We believe sufficient implementation guidance is a key to consistent and comparable application of the proposed standard. For this standard to be operational, the Boards need to use more complex examples which would truly reflect the situations requiring substantial judgment. Such examples would include complicated scenarios with the purpose of clarifying the principles.
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?

Conceptually, we agree with the proposed distinction and accounting for product warranties. We believe, however, the proposed guidance will increase the reporting complexity while providing very little benefit. In addition, it could prove impractical in making a clear distinction between the latent defects and those which arise after the product is transferred to the customer. We believe the current U.S. GAAP standards pertaining to product warranties are sufficient to provide users with decision useful information.

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 license; and

(b) if an entity grants a customer a nonexclusive license to use its intellectual property, it has a performance obligation to transfer the license and it satisfies that obligation when the customer is able to use and benefit from the license.

Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the patterns of revenue recognition proposed by the Boards? Why or why not?

We believe the idea of exclusiveness, as presented, is ambiguous in the proposed standard. Although the implementation guidance provides some perspective on exclusivity, we believe the Boards should provide more clarification. Otherwise, different entities will apply different recognition criteria for exclusive vs. non-exclusive rights, which will result in a lack of comparability.
**Consequential amendments**

*Question 17: The Boards propose that in accounting for the gain or loss on the sale of some nonfinancial 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 entities should apply the recognition and measurement principles of the proposed revenue model in accounting for the gain or loss on the sale of some nonfinancial assets. The proposed standard is practical in application and enhances the consistency of the financial statements. We recommend the Boards define more clearly what constitutes nonfinancial assets, or refer to definitions elsewhere in GAAP.

**Nonpublic entities**

*Question 18: Should any of the proposed guidance be different for nonpublic entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?*

We generally agree the proposed guidance should be the same for both public and nonpublic entities. We indicated earlier there is a need to reduce the disclosure requirements. We believe the nonpublic entities should be exempt from filing extensive disclosures.