January 17, 2018

Susan M. Cosper, CPA
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Recommendations Related to ASC Topic 606, Revenue from Contracts with Customers, for Private Companies and Certain Conduit Debt Obligors

Dear Ms. Cosper:

The American Institute of CPAs (AICPA) is the world’s largest member association representing the accounting profession, with more than 418,000 members in 143 countries, and a history of serving the public interest since 1887. One of the objectives that the Council of the AICPA established for the PCPS Executive Committee is to speak on behalf of local and regional firms and represent those firms’ interests on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with these objectives. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC members have been discussing the revenue standard with their private company clients as well as with AICPA’s Center for Plain English Accounting (CPEA). The CPEA has provided frequent webcasts on the new revenue standard as well as approximately 100 member firm trainings on the new revenue standard since ASU 2014-09 was issued in 2014. This letter represents the collective feedback we have received from those constituents as well as our observations and recommendations.

GENERAL COMMENTS

We appreciate the Board’s efforts in developing a new standard for revenue. We believe this could be one of the most significant changes made to U.S. GAAP in many of our careers, and appreciate the effort and outreach it took to develop this robust principles-based standard for revenue, which is typically the single most significant item on an entity’s financial statements.

We note, however, a lack of apparent consideration of recognition and measurement practical expedients for private companies which occurred due to the timing of development of the new revenue standard. The recognition and measurement decisions were substantially converged with IFRS (for listed entities only) prior to the creation of the Private Company Council. The Basis
for Conclusions for ASU 2014-09 does not note any consideration of recognition and measurement differences for private companies. This is in contrast to the existence and consideration of private company practical expedients in both the new lease standard (ASU 2016-02) and financial assets credit losses standard (ASU 2016-13). We believe that the magnitude and significance of the new revenue standard warrants robust consideration of recognition and measurement differences for private companies as well as disclosure differences for certain conduit debt obligors. In this letter, we have included specific areas the Board may wish to consider and we are happy to further discuss these specific areas.

The Private Company Decision-Making Framework (PCDMF) notes that in determining recognition and measurement guidance, the Board and Private Company Council, “should determine whether the recognition or measurement guidance being evaluated provides relevant information to users of private company financial statements at a reasonable cost.” We believe that revenue as a whole is highly relevant information to users of private company financial statements. However, we do not believe that certain individual requirements (detailed in this letter) in determination of the amount and timing of revenue to be recognized provide relevant information to users of private company financial statements at a reasonable cost.

We note that while the new revenue standard is substantially converged with IFRS (specifically IFRS 15), this convergence only extends to listed entities applying either IFRS or U.S. GAAP. We are not aware of other jurisdictions outside the United States which will be requiring the new revenue standard for non-listed entities (this includes IFRS for SMEs). As a result, we question whether one of the primary benefits of the new revenue standard applies to private companies. In fact, one could question whether the additional cost burdens placed on private companies to comply with the new revenue standard in the United States place them at a competitive disadvantage versus foreign non-listed competitors.

The Summary of ASU 2014-09 indicates that, “[n]onpublic entities are not subject to [Staff Accounting Bulletin (SAB) Topic 13, Revenue Recognition]; however, the Board understands that some apply it in practice by analogy.” Therefore, some nonpublic entities do not apply SAB Topic 13 by analogy. A number of concepts in the new revenue recognition standard are similar to concepts in SAB Topic 13, such as, but not limited to, persuasive evidence of an arrangement and proportional performance. For those nonpublic entities that do not apply SAB Topic 13 by analogy, those concepts in the new revenue recognition standard may present an incrementally substantial hurdle.

The New Definition of an Accounting Contract

The new accounting definition of a contract has been deemed quite rigid by some practitioners and preparers (ASC 606-10-25-1). In particular, ASC 606-10-25-2 indicates that [emphasis added], “[a] contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law.” Thus, private companies must move from “realizable” to legally enforceable, which some view as a
substantial incremental burden. There already is diversity in practice on what this means and how to satisfy this requirement.

Private companies may have to put in place stronger internal control systems over the contracting process and over sales and marketing teams to ensure everyone who is now a part of this new five-step process is familiar with the accounting ramifications and the new requirements to be able to recognize revenue. We believe this may put a substantial cost burden on smaller private companies to potentially hire new staff or train existing staff on these more complicated new requirements.

To the extent revenue recognition is delayed due to a private company not satisfying the strict (often non-cash related) requirements of the new accounting definition of a contract, we believe that financial statement users “will adjust financial statements by substituting an alternative accounting approach” (PCDMF 1.6d).

We recommend the Board consider providing some implementation guidance and clarity on this issue to reduce diversity in practice, perhaps going through the TRG to develop some guidance regarding some of the practical issues that might arise when applying the standard to smaller, less complex private companies.

Customer Options for Additional Goods and Services that are a Material Right

Step 2 of the new revenue standard requires that customer options for additional goods and services that are a material right be considered distinct performance obligations (ASC 606-10-55-42). This will typically result in a new additional unit of account for many private companies for items such as loyalty points, discounted (from standalone selling prices) renewal options, incremental and significant discount vouchers obtained from purchases and other implied performance obligations that are a valid expectation of the customer at the time of the transaction. Identification and quantification of these new units of account will require a level of internal controls not typically found at many private companies. We also question the relevance of new revenue units of account for private companies, particularly when all of the cash inflows from the transaction have been received by the entity (PCDMF 1.6a).

We recommend that private companies be permitted to continue to apply, by accounting policy election, the incremental cost method for customer options for additional goods and services that are a material right. Alternatively, the Board may wish to consider allowing private companies to use the exception created by ASU 2016-10 (in ASC 606-10-25-16A) to disregard performance obligations that are not material in the context of the contract for customer options for additional goods and services that are material rights (not permitted presently by ASC 606-10-25-16B).
Conduit Debt Obligors

In its letter dated October 23, 2017, in response to the FASB Exposure Draft, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made* (ED), TIC shared concerns regarding the effective date of that proposed standard for not-for-profit (NFP) conduit debt obligors. That proposed standard is intended to be effective January 1, 2018, for certain entities (public business entities [PBEs] and conduit debt obligors, for example), which is aligned with the revenue standard effective dates. However, it appears that this proposed standard will not be issued as final until the second quarter of 2018. TIC is concerned that this standard will essentially not be issued until after the effective date of the revenue recognition standard for certain entities and, therefore, there will not be enough time to adopt the amendments made by this standard. TIC urged the Board in that comment letter to reconsider the effective date of the revenue recognition standard for NFP conduit debt obligors given the fact that this standard will not be issued until 2018, after FASB ASC 606 is effective for those entities.

TIC’s concerns go beyond just the requirements proposed in that ED, but also to the new revenue recognition guidance as it relates to NFP conduit debt obligors. TIC fears that some NFP entities with conduit debt may not realize they fall under the definition of a conduit debt obligor and, therefore, will be unaware they have to adopt aspects of the new standards at the same time as PBEs.

We also encourage the Board to examine the disclosure requirements in the new revenue standard for all conduit debt obligors (both NFP and for-profit). The current disclosure requirements in the revenue standard for conduit debt obligors are identical to disclosures for issuers of public equity. We question whether financial statement users who hold public EQUITY have the same disclosure needs as users who hold conduit DEBT obligations.

Anecdotally, we are aware of conduit debt obligors who intend to refinance or retire conduit debt obligations with a purpose of escaping the accelerated effective date and the additional disclosure requirements of the new revenue standard. We do not believe that conduit debt obligors should be subject to the same adoption and disclosure requirements as other PBEs.

There is also some confusion as to the different methodologies being applied to the required effective dates of recently issued standards for conduit debt obligors. For example, ASU 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* and ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, give conduit debt obligors one additional year to adopt from entities that are required to file with the SEC. However, other recently issued ASUs, including the revenue standard, do not differentiate between conduit debt obligors and SEC filers from an effective date standpoint.
Short-Cycle Manufacturing Contracts

Under the new revenue standard, entities are required to recognize revenue over the life of a contract (rather than at a point in time) when there is no alternative use for the good or service and an enforceable right to payment for performance to date (ASC 606-10-25-27c). No exception exists for short-cycle arrangements. As a result, short-cycle manufacturing companies (whether they be public or private companies) will have to recognize revenue over the manufacturing cycle on some contracts pursuant to Topic 606 rather than typically when the products are shipped (pursuant to Topic 605). On other contracts, where an enforceable right to payment for performance to date does not exist, revenue will likely be recognized at a point in time, typically shipment. Companies will have to have controls over contracts in place to be able to discern for what products in the manufacturing process an enforceable right to payment for performance to date exists. This will include a detailed review of all contracts in place with an emphasis on provisions regarding customer termination for convenience. We question the costs associated with this process where the manufacturing cycle is short.

In many cases, we foresee private entities performing top-side entries outside of their normal financial reporting process and system of internal controls at year-end in order to comply with this aspect of the standard. We fear such estimates may not be very accurate depending on the entity’s process to estimate which products have an enforceable right to payment when the manufacturing cycle is not yet complete.

We believe this issue would apply to both public and private companies with a short manufacturing cycle. However, as noted above, a private company (particularly in this industry) may not have the controls over contracting in place (including legal determinations regarding enforceability) in order to efficiently or effectively determine whether an enforceable right to payment for performance to date exists. The costs associated with a detailed and rigid control process over contracting in this context does not seem to be warranted.

Our recommendation is for a practical expedient for private companies to allow short-cycle manufacturing companies to disregard an enforceable right to payment for performance to date in determining whether they must recognize revenue over the life of the contract. We would be happy to work with the Board on some parameters and scope in order for entities to be able to apply an expedient to short-cycle manufacturing contracts.

Out-of-Pocket Costs

It is our understanding that, under the new revenue standard, any out-of-pocket costs (travel, meals, lodging, etc.) to be reimbursed (generally at cost) generally would need to be estimated as part of the transaction price in Step 3 (subject to the constraint on variable consideration) and recognized as revenue based on the method determined in Step 5. If it is determined that revenue must be recognized over the life of the contract, depending on the measure of progress selected, this may accelerate revenue recognition and profit margin for out-of-pocket costs which typically have little or no incremental profit margin. For private companies in particular, this
estimation process will be arduous and result in much more accounting complexity for little added benefit. Moreover, the resulting margin acceleration and revenue distortion may not be representationally faithful to the contract.

Also, we foresee complexities regarding the appropriate measure of progress where out-of-pocket costs are significant. For service type entities including advertising, marketing, legal, branding, accounting, and other service firms, the cost and complexity of estimating these costs up front may be a significant undertaking.

Our recommendation is for the Board to consider a practical expedient to allow private companies to recognize revenue on out-of-pocket costs based on the amount to be reimbursed when the costs are incurred.

Conclusion

We recognize and appreciate the efforts of the Board to become more responsive to the needs of the private company constituency and appreciate the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Michael A. Westervelt, Chair
PCPS Technical Issues Committee

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cc: PCPS Executive and Technical Issues Committees