March 14, 2012

Technical Director – File Reference No. 2011-230
Financial Accounting Standards Board
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International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
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Via Electronic Mail: director@fasb.org, File Reference No. 2011-230

Re: Proposed Accounting Standards Update (Revised), Revenue Recognition (Topic 605): Revenue from Contracts with Customers

Dear Sir/Madam:

Standard & Poor’s Ratings Services (Standard & Poor’s) appreciates the opportunity to provide the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards) our comments on the Boards’ Proposed Accounting Standards Update (Revised), Revenue Recognition (Topic 605): Revenue from Contracts with Customers (the Proposed Standard). The views expressed in this letter represent those of Standard & Poor’s Ratings Services and do not address, nor do we intend them to address, the views of any other subsidiary or division of Standard & Poor’s Financial Services LLC or of its parent, The McGraw-Hill Companies. We intend our comments to address the analytical needs and expectations of our credit analysts.1

General

Standard & Poor’s Ratings Services supports international harmonization of accounting standards, and believes a common set of high quality, consistently enforceable accounting standards would best facilitate efficient global capital markets. We believe

1 The opinions stated herein are intended to represent Standard & Poor’s Ratings Services’ views on potential changes in accounting and financial reporting standards. Our current ratings criteria and the application of their related principles, methodologies, and assumptions are not affected by our comments on the Proposed Standard.
convergence between U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) should be a significant consideration and a priority for the Boards when deliberating standards. Because we rate companies globally, comparable accounting is important to our peer analysis and comparisons.

Accordingly, we strongly support the Boards’ objective to develop a comprehensive, common revenue recognition standard. We agree with the Boards’ goals of removing inconsistencies that exist in current revenue recognition guidance and practices, and improving comparability across entities, industries, and jurisdictions. We also welcome the better information about the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers that should result from applying the Proposed Standard.

We believe most financial-statement users place significant emphasis on revenue, related costs, and disclosures, both historical and forward-looking. Revenue drives key analytical metrics such as operating income, EBIT, and EBITDA. Accordingly, we believe the revenue recognition model ultimately adopted should provide:

- A representative view of the cash to be ultimately realized;
- A meaningful depiction of a company’s revenue-generating capabilities;
- A depiction that is commensurate with the economics of transactions;
- Increased consistency both within and among accounting regimes facilitating better period-to-period and peer-data comparisons; and
- Robust disclosures, including the estimates and judgments applied, and the rationale behind such judgments.

While we generally agree with the contract-based principles in the Proposed Standard, and many of the modifications made to the original proposed Accounting Standards Update, we have some areas of concern. We believe certain aspects of the proposed guidance:

- Lack clarity, application guidance, and detailed disclosure regarding certain principles and industry-specific transactions;
- Require greater use of estimates, managerial interpretation, and judgments that may lead to increased diversity in revenue recognition practices within an industry, potentially resulting in decreased levels of comparability;
- May increase the disparity between revenue reported and actual cash flows;
- Move the accounting further away from the economics of a transaction, and may not be consistent with how management views the transaction in operating the company, thereby requiring more expansive disclosures;
- Add unnecessary complexity to the analysis performed by financial statement users; and
- Provide unneeded optionality that could lead to greater inconsistency across peer companies.

We believe certain provisions of the Proposed Standard provide an opportunity to enhance users’ ability to perform analyses, while other aspects may potentially impair the usefulness of financial reporting. However, in our position as a user of financial
information it is difficult to anticipate the Proposed Standard’s impact without detailed contract information. We therefore recommend that, before finalizing the Proposed Standard, the Boards perform field testing (including financial-statement users) to determine the adequacy of the current implementation guidance for companies and the utility of the reported outcomes for users.

Despite our concerns, we believe the Proposed Standard will be an improvement over existing standards and provide better financial information for users—as long as it is consistently applied, accompanied by adequate disclosure and audit enforcement of its principles. Our specific concerns and recommendations follow.

**Transfer of Control**

We support the Proposed Standard’s concept of control because we believe it would be workable for most asset transfers. We believe the “risk and reward” indicator set forth in paragraph 37 is important to the determination of transfer of control. Specifically, we believe that when a company is evaluating whether control is relinquished, it should determine if significant risks and rewards of ownership have been transferred. In our view, revenue recognition should occur upon the transfer of both control and substantial risks from the seller to the buyer; therefore, the concept of risk transfer should be included in the definition of control in paragraph 32. There are transactions where sellers retain significant risks related to transferred goods or services (e.g., real estate sales). In our view, if companies do not include the risk and rewards concept when determining control, it could lead to inappropriate up-front revenue recognition making it difficult to analyze a company’s economic risks. At a minimum, we believe the Proposed Standard should include disclosures about the risks to which a seller continues to be exposed, and any restrictions on the assets (e.g., recourse or guarantee arrangements).

**Credit Risk**

We support the requirement to measure revenue without regard to collectability and present bad debt expense separately. In our view, netting credit risk commingles information on how management addresses credit reserving with revenue recognition. The revised proposal to present uncollectible amounts because of credit risk as a separate line item adjacent to the revenue line item would better allow the separate analysis of revenue growth and credit risk management.

**Time Value of Money**

We agree with the concept of recognizing the effects of the time value of money; however, we believe its application should be more limited than currently proposed. Further, we believe the current provisions may stray from the core principle of the standard, and could render reported revenue and interest expense less analytically relevant.

The core principle of the Proposed Standard is stated in paragraph 3:

“...an entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.”
We believe an entity’s expectation of consideration to be received is based largely on market pricing and industry-standard payment terms. Imputing interest based on the timing of delivery or performance will alter the revenue recognized for what is otherwise a standard transaction. Therefore, rather than keying the imputation of interest off of the date of service or delivery, we propose keying it off of the industry standard payment terms. While the Boards added a factor in paragraph 59(b) that to some degree addresses this notion and could reduce the instances in which interest is imputed, we believe this factor could be inconsistently applied and, if interest were imputed, we do not believe it should be calculated based on service or delivery date, but rather on industry norms.

In our view, this will distinguish and separate the embedded financing element in a more appropriate and practical manner. We understand the conceptual underpinning of the proposal, but suggest financing elements be separately recognized only when they are a clear element of the contractual agreement.

**Constraint on Revenue and Reasonable Assurance**

We agree with the need to constrain revenue to that which the entity is reasonably assured to be entitled; however, it is unclear how including this constraint as a life-to-date cap, rather than a constraint on the transaction price, would affect the timing of revenue recognition. We would not support the current model if it could result in an entity reporting inflated margins in earlier periods and negative margins in later periods, when the variable consideration is not ultimately realized. We therefore believe clarification of the interaction between the potential application of the reasonably assured threshold on the transaction price and the life-to-date cap on recognition is needed.

We also ask the Boards to provide more guidance about what constitutes “reasonably assured”.

**Onerous Performance Obligation Test**

We generally agree with the onerous performance obligation test, as proposed. However, we provide the following comments regarding measurement and scope:

- We do not agree with using the amount an entity would pay to exit a performance obligation as the basis for measurement. We believe that, even if contracts allow for it, vendors generally settle onerous performance obligations via performance. Unless an entity plans to exit, we believe it should measure the liability assuming that the goods or services will be transferred, and the contract will not be cancelled. This approach would be consistent with how entities are required to estimate the transaction price in accordance with paragraph 51 of the Proposed Standard.

- The Proposed Standard requires the onerous performance obligations provisions be applied only to performance obligations that an entity satisfies over time. We do not agree with this scope, and believe the provisions should be applied to performance obligations satisfied at a point in time as well. This would be
consistent not only with the treatment of performance obligations satisfied over
time, but also other similar transactions such as recording inventory at the lower
of cost or market.

Disclosures
The Proposed Standard offers a significant overhaul of the disclosures of the nature,
amount, timing, and uncertainty of revenue and cash flows arising from contracts with
customers. Disclosures are key facets in analyzing a range of information related to
revenue recognition. We generally support the proposed disclosure requirements, but
believe they can go further in providing a framework to help users understand economic
drivers and their effects on companies.

Interim Disclosures
We agree that an entity should provide each of the proposed disclosures in its interim
financial statements: Financial statement users rely on both interim and annual financial
statements when analyzing a company’s business, financial position, and results. The
relevance of revenue generated by a company and the accompanying disclosures are not
confined to an annual period. In our view, apart from accounting policy information that
has remained unchanged during periods subsequent to the annual reporting, interim
disclosures should mirror the disclosures provided on an annual basis.

Disaggregation of Revenue
We fully support disaggregating revenue into categories that best depict how the nature,
amount, timing, and uncertainty of revenue and cash flows are affected by economic
factors. We agree with the examples of potential revenue disaggregation categories
identified in paragraph 115 and recognize that companies are not limited to these
disclosures.

However, we also recommend the disaggregation disclosure include the commensurate
costs and margins, because we believe understanding businesses’ returns is more
important to users of financial statements than just the top line.

Reconciliation of Contract Assets and Liabilities
We support the Boards requiring a tabular reconciliation from the opening to the closing
aggregate balance of contract assets and contract liabilities and the proposed
reconciliation line items. However, we believe the effects of the time value of money and
changes in estimates should also be explicitly disclosed. Additionally, we believe
companies should disclose qualitative information that is relevant to understanding the
components of the reconciliation of the contract asset and liability line items.

Reasonably Assured Threshold
In the event the Boards finalize the standard as proposed, we believe it should explicitly
require companies to disclose how they define "reasonably assured" as it relates to the
specific facts and circumstances of their business activities and how their transactions
have met--and potentially could meet--that threshold. The reasonable assurance criteria will affect revenue recognized including constrained revenue from variable consideration. Hence, given the potentially extensive level of judgment companies might apply in determining whether its experience is predictive of the amount of consideration to which it will be entitled, we believe disclosing the factors applied to determine how the "reasonably assured" threshold is met is important.

**Time Value of Money**

The Proposed Standard requires companies to adjust promised amounts of consideration to reflect the time value of money when a contract has a significant financing component. We believe understanding how earnings translate into cash is important to users of financial statements; therefore, we recommend the required disclosures be more robust than currently proposed. Specifically, for each reporting period, we recommend requiring disclosure of the amount of imputed interest recognized and the amount by which reported revenue differs from the cash expected to be received. Additionally, we would like to see qualitative information on how the company determined a financing component is significant to the contract.

**Nonpublic Entity Disclosure**

We do not believe the Proposed Standard should contain different disclosure requirements for nonpublic entities. Drawing a distinction in the accounting or reporting requirements between public and nonpublic companies is arbitrary, and assumes the sophistication of entities and needs of financial statement users are driven by this organizational difference.

**Analysis of Remaining Performance Obligations**

We support the Boards’ proposal for disclosing an explanation of when an entity expects to recognize the aggregate amount of the transaction price allocated to remaining performance obligations. We believe such information would be useful in forecasting future cash flows. However, we believe including short-term contracts in this disclosure would augment its usefulness. For certain industries (such as shipping, aircraft chartering, and certain construction-related companies), short term contracts form a significant portion of their revenue. We encourage the Boards to consider including contracts with durations of less than one year, to provide more complete and relevant disclosures of pending performance obligations.

We do not believe companies should have an option to disclose their analysis of remaining performance obligations on either a quantitative or--substantially more limited--qualitative basis. The disclosure will be less meaningful if the quantitative allocation by appropriate time band for the duration of the remaining performance obligation is condensed and merely described in broad terms. While the qualitative disclosure would provide more information than is currently disclosed, we do not believe the qualitative option would meet the objective of the disclosure for users of financial statements.
Disclosure Framework

We also support the FASB’s separate project to establish an overarching disclosure framework. We strongly encourage the Boards to work together on a comprehensive disclosure framework, giving further consideration to additional relevant disclosures related to revenue recognition.

Optionality

To provide relief from application, practical expedients have been provided throughout the Proposed Standard, and it is at the issuers’ election to invoke these practical expedients. Optionality, potentially leading to incomparable financial statement presentation, may make it difficult for users of financial statements to analyze similar companies and effectively deploy capital. It can also potentially lead to management of results by issuers that might elect policies on the basis of achieving favorable financial statement outcomes that may not necessarily best reflect the economics of the transactions. For example, the Proposed Standard provides an option for companies to apply the time value of money to transactions with less than a one-year difference between satisfaction of a performance obligation and payment from the customer. By electing to apply the time value of money concept to prepayments from customers, companies could inflate revenue and margins relative to their peers that do not elect this policy. We are not advocating that the Boards create accounting standards to address the possibility of abuse. Rather, we encourage the Boards to eliminate optionality from the Proposed Standard and if practical expedients are still deemed necessary, mandate them instead of allowing them in order to create standards that could be applied more uniformly.

Effective Date and Transition

Broadly, we agree with the Boards’ holistic approach to reviewing the adoption dates of the various standards currently under proposal as part of the Effective Dates and Transition Methods project.

We generally view full retrospective implementation as optimum, because it is most helpful to our analysis of period-to-period trends. Additionally, our ratings are on a relative basis, so comparability of peer data is paramount. We therefore ask that there be a synchronization of adoption dates for public and nonpublic companies. We are sensitive to the burden that adoption of such a standard will likely impose on issuers, and therefore favor a sufficiently deferred adoption date to accommodate all entities, both public and nonpublic (e.g., for annual reporting periods beginning on or after Jan. 1, 2016).

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We thank you for the opportunity to provide our comments on the Proposed Standard. We would be pleased to discuss our views with any member of the Boards or your staff. If you have any questions or require additional information, please contact the undersigned.

Very truly yours,

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