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Revision of Exposure Draft "Revenue Recognition (Topic 605)"

Liberty Global, Inc. (LGI) appreciates the opportunity to comment on the Revision of Exposure Draft of the Proposed Statement of Financial Standards "Revenue Recognition (Topic 605)" (the Revised ED) issued jointly by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards). LGI is an international provider of video, voice and broadband Internet services, serving over 19.5 million customers across 13 countries.

LGI continues to support the Boards' broad goals in the revenue recognition project, and we believe the Revised ED is a significant improvement over the original Revenue Recognition exposure draft. However, we continue to have certain concerns with the Revised ED from both a theoretical and operational perspective. This comment letter is limited to addressing our particular areas of concern including, (1) identification of distinct performance obligations and allocation of transaction price to performance obligations, (2) treatment of nonrefundable upfront fees and interpretation of when a contract contains a "material renewal right", (3) assessment of contract modifications, and (4) application of the Revised ED on a portfolio basis as a practical expedient. We believe that the application of certain provisions in the Revised ED, particularly those related to sales incentives and promotional offers, could result in a revenue recognition pattern that may not reflect the substance of transactions with our customers, unless the Revised ED is clarified in certain areas.

We also have concerns related to the proposed effective date of the final standard as expressed further below.
Specific Comments on the Revised ED

Identification of Distinct Performance Obligations and Allocation of Transaction Price

Paragraph 28 of the Revised ED states that a good or service is distinct if either of the following criteria are met:

a) The entity regularly sells the good or service separately.
   b) The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer. Readily available resources are goods or services that are sold separately (by the entity or another entity) or resources the customer already has obtained (from the entity or from other transactions or events).

We believe the term “distinct” needs definitional clarity in the Revised ED to ensure consistent application among preparers.

The identification of whether equipment deliverables may represent distinct performance obligations is particularly challenging in the telecommunications industry given the significant interdependence between a providers’ service and the hardware needed to deliver that service. In applying the provisions of the Revised ED, we may end up in a position where some equipment provided to customers is considered distinct, while other equipment is not considered distinct. Specifically, we are not certain whether the definition of “distinct” operates similarly to “stand-alone” value under current GAAP or has an alternative meaning. For example, we deliver our video services using set-top boxes that can only be used on our network. We principally rent these set-top boxes to customers, but may also sell them to our customers and, if sold, we permit an alternative customer to use the set-top box if the box is sold to them from the first customer. Under the concept of stand-alone value in existing GAAP, we believe a separate element exists only in the scenario where the set-top box is sold to the customer. Under the Revised ED, we are not certain whether a performance obligation exists in either scenario. Overall, we believe the intent of the Revised ED is to treat rental and sale of set-top boxes as separate performance obligations, and we would generally be supportive of that conclusion. However, we believe the Revised ED should be clarified on this point. We believe paragraph 28 could be improved if language such as the following was added (bold for changes from the current text of the Revised ED):

The entity regularly sells the good or service separately or the customer could resell the good or service separately. Satisfaction of this condition does not depend on the existence of an observable market for the good or service.

While we believe our equipment-related deliverables should be treated as separate performance obligations, we believe the allocation methodologies currently prescribed in the
Revised ED should be modified. Sales of equipment to customers will generally be at a price that is lower than our cost to purchase the equipment, because the sale of equipment is not our primary business objective. Rather, our primary objective is to obtain long-term customers to our monthly service offerings, and subsidizing the inter-related equipment costs to the customer is one way to help drive subscriber growth. We do not believe it is appropriate to perform a relative selling price allocation between our equipment deliverables and ongoing service deliverables, as this type of allocation would not be reflective of business and economic view of these transactions (i.e. as essentially a recovery of a part of the cost of acquiring the customer). Our recommendations for modifying the allocation criteria in the Revised ED are discussed further below.

Further, we believe the application of the literal words in the Revised ED will lead to illogical conclusions with regards to many of our promotional service deliverables. For example, a customer may sign-up to a one-year contract for basic cable services. As an added incentive and to drive up-take of premium services, we may provide a premium channel, such as a film or sports channel, to the customer with no charge for the first three months. After the first three months, the customer will then decide whether or not to add the premium channel to the basic video package, and pay a higher rate going forward, or let the free promotion lapse. Our interpretation of the Revised ED is that the premium channel is distinct because, although the premium channel will never be sold on a separate basis, the customer does separately benefit from this a-la-carte service. As a result, assuming the customer does not decide to purchase the premium channel service after the free period, more revenue would be allocated to the first 3 months when the premium channel is provided for free than to the remaining months under contract, based on the current wording in the Revised ED in paragraph 75, which states that a discount may not be allocated entirely to a particular performance obligation unless two criteria are met, including the "entity regularly sells each good or service in the contract on a standalone basis". We believe that this accounting answer is not reflective of the overall nature of our service relationship with the customer given that this is purely a promotional tool and would, in our view, result in inappropriate front loading of revenue. Moreover, such an accounting answer would require costly and time-consuming modifications to our billing and accounting systems given the large volume of such promotional offers and modifications that routinely occur in our operations.

Overall, we believe our concerns around equipment and promotional deliverables could mainly be resolved by:

1. Maintaining a “contingent revenue cap” that exists in current U.S. GAAP. However, we note that the Boards have expressly addressed this point in paragraphs BC193 through BC197. While we understand the basis for some of the Boards’ concerns, we continue to believe that the absence of a contingent revenue cap for our industry could result in aggressive and misleading accounting results. In our view, the contingent revenue cap better matches the business and economic view with respect to sales of equipment at discounts and promotional offerings, including “free services”.

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2. With respect to equipment deliverables, allowing (or requiring) a residual allocation methodology in cases where equipment provided upfront is inseparable from the service provided, the price for the ongoing services is not impacted by the nature or form of any equipment-related performance obligations, and the equipment is rarely (or never) sold on a standalone basis. We understand there are significant challenges in this application across industries, so another approach to would be to allow a residual method or contingent revenue approach when the upfront equipment is sold to the end customer at a price that is significantly lower than the cost to acquire such equipment. We believe our proposed changes are within the spirit of paragraph 70 of the Revised ED, which states that “an entity shall allocate the transaction price to each separate performance obligation in an amount that depicts the amount of consideration to which an entity expects to be entitled in exchange for satisfying each separate performance obligation.”

3. With respect to promotional deliverables such as free periods for premium channels, slightly altering the language in paragraph 75(a) of the Revised ED would result in accounting that better matches the business and economic nature of these transactions. Under the current wording, discounts can only be allocated to specific performance obligations if both (a) the entity regularly sells the good or service in the contract on a standalone basis and (b) the observable selling prices from those standalone sales provide evidence of the performance obligation(s) for which the entire discount in the contract belongs. We believe these criteria were intended to qualify for certain of our examples, such as where we provide a premium channel for free for a portion of time when a customer signs up for one of our ongoing service packages. However, we do not believe the paragraph 75 guidance would allow for a specific allocation of the discount since we never sell the premium channel on a standalone basis. While the premium channel won’t ever be sold on a standalone basis, we do have stated pricing for this service as an a-la-carte offering. In order to cover scenarios such as this where an item is offered on an a-la-carte basis as an add-on to base services, we recommend that the FASB change paragraph 75(a) to read “the entity regularly prices the good or service in the contract on a standalone basis”.

We are also uncertain as to how the Revised ED will interact with potential changes in the lessor accounting model. We believe the application of the proposed lessor “receivable and residual model” with respect to our equipment deliverables will lead to further confusion in our accounting model. Our concerns in this area mainly revolved around the proposed leasing rules, and we will comment on such matters when a new lease exposure draft is released. Overall, we believe the short-term rental of our equipment to customers should continue to be accounted for under an operating lease and/or service agreement model.
Treatment of Non-refundable Upfront Fees and Interpretation of When a Contract Contains a Material Renewal Right

As per paragraphs IG 29 through IG 32 of the Revised ED, in many instances non-refundable upfront fees will not be considered separate performance obligations, because they do not result in the transfer of a promised good or service to the customer. In these cases, the upfront fees are considered advance payments for future goods and services, and are recognized as revenue when those future goods and services are provided. As per paragraph IG 30, the revenue recognition period would extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and the option provides the customer with a material renewal right, as specified in paragraph IG 21.

Our interpretation of the Revised ED is that our contracts do not provide a material renewal right to the customer, because (1) at the end of the contractual term, the customer will renew at the prevailing rate for the applicable service package that is available to every other potential or existing customer, (2) we make no guarantee of the price or exact level of services that will be available after the contract period, (3) the upfront fees are generally not very significant in relation to ongoing service fees, and (4) upfront fees are often waived in the effort to drive subscriber growth. As such, under the Revised ED, we believe non-refundable upfront fees would be recognized over the contractual period in our fact pattern, assuming the contract creates enforceable rights and obligations under paragraph 13 of the Revised ED, even if the contractual period is very short (i.e. month-to-month).

Overall, we recommend that the Revised ED should be clarified on this point. In other words, we believe further guidance should be provided on determining when a renewal option in a contract results in a material right. For example, paragraph IG21 could be changed to state (bold for changes to current wording):

If in a contract with more than once performance obligation an entity grants the customer the option to acquire additional goods or services, that option gives rise to a separate performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into that contract (for example, a significant discount to standalone prices as compared to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market).

This change would help emphasize that the renewal right has to be material with respect to the pricing of the renewed services, and that the analysis is based on a comparison to the standalone pricing for the ongoing services available to other customers. Further, the change would clarify that simply avoiding an upfront fee on renewal is not a “discount” resulting in a material right as might be implied by the literal words in the existing Revised ED. We would
also encourage the addition of examples to the implementation guidance to help clarify the application of the material rights guidance.

**Assessment of Contract Modifications**

Based on our review of paragraph 22(a) and Example 2 in paragraph IG61, we believe the Revised ED intends for us to conclude that under a contract for repetitive services, such as cable, internet or voice services, the remaining services to be rendered pursuant to the contract at the point of any modification are distinct from those already provided. For example, a two-year contract for repetitive services provided on a monthly basis would represent 24 monthly performance obligations. As we strongly believe that remaining services to be offered under these types of contracts should be considered distinct from the services already provided, we suggest that the guidance in paragraph 22(a) and in Example 2 in paragraph IG61 be expanded to clarify this point. For example, the following could be added to the end of paragraph 22(a):

> Under repetitive services contracts, remaining services are generally distinct from services previously provided to the customer.

If this type of language is not considered appropriate in the body of the standard, we believe the language could be added to the implementation guidance.

In the event our interpretation is incorrect and the remaining services in a repetitive services contract would not be considered distinct from the services already provided, we would encounter significant difficulties in implementing the Revised ED based on the large volume of contract modifications that we routinely experience. For example, in one or our larger markets, with almost 2 million customers, approximately 75% of service contracts are modified at least once during their terms. Implementing billing and accounting systems to track the large volume of modifications in each of our countries would be incredibly time-consuming and cost prohibitive.

**Application of the Revised ED on a Portfolio Basis as a Practical Expedient**

According to paragraph 6, an entity may apply the guidance in the Revised ED to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects the result of doing so would not differ materially from applying the Revised ED on a contract by contract basis. LGI serves over 19.5 million customers across 13 countries for which we provide various video, internet and voice services on a monthly basis. Overall, we believe it may be difficult to put a portfolio approach into practice given the wide array of services we provide, the ever-changing promotions and the frequent modifications that occur to customers contracts. However, given the large volume of relatively small transactions, applying a portfolio approach might be helpful to LGI in certain situations, such as the
accounting for the assets that arise from 1) free goods or services provided at the beginning of a contract, or 2) costs incurred in fulfilling or obtaining a contract.

If we decide the application of portfolio accounting would be helpful as a practical expedient in certain circumstances, we believe grouping customers with “similar characteristics” would be difficult to put into practice given the large menu of choices provided to our customers. As such, we believe the “similar characteristics” requirement should be broad enough as to be meaningful as a practical expedient, and that the Revised ED should be adjusted for this point.

In addition, the guidance in the Revised ED would effectively require a “proof” that applying a portfolio approach would not differ materially from applying the Revised ED on an individual contract basis. The requirement to provide such a proof would negate any real benefit of applying a portfolio approach. In order for the portfolio approach to provide a meaningful practical expedient, we believe the Revised ED should be adjusted to remove the requirement for an explicit proof.

**Effective Date**

The Revised ED indicates that the final standard would not be effective earlier than annual reporting periods beginning on or after January 1, 2015. As the standard requires retrospective application, with certain practical expedients, the comparative periods impacted by the final standard could be as early as the annual reporting period beginning on January 1, 2013 (ignoring selected financial data requirements).

We envision the potential need for major efforts to implement the final standard, including 1) IT system overhauls and the potential need for new systems, 2) in-depth training and educational efforts, and 3) major verification work to ensure changes in systems and processes appropriately capture the requirements of the final standard. In order to avoid significant disruption to our operations, and to ensure that we have the time to implement a final standard in a thorough manner, we recommend that the effective date be delayed to at least annual reporting periods beginning on or after January 1, 2017.
We appreciate the opportunity to provide you with our views on the ED. If you have any questions regarding our comments, please contact me at 303-220-6603, Leo Stegman, Vice President of Accounting and Reporting, Deputy Controller at 303-220-6690, or Brian Zook, Vice President of Accounting Policy at 303-220-6632.

Sincerely,

Bernard G. Dvorak
Executive Vice President & Co-Chief Financial Officer

cc Leo Stegman, Vice President, Accounting and Reporting, Deputy Controller
    Brian Zook, Vice President, Accounting Policy
    Jason Waldron, KPMG