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Technical Director
File Reference: No 1660-100
Financial Accounting Standards Board of
The Financial Accounting Foundation
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Comment Letter on the Discussion Paper Preliminary Views on Revenue Recognition in Contracts with Customers

Tyco appreciates the opportunity to respond to the discussion paper. Overall we agree that the Board is moving in the right direction with the guidance outlined in the discussion paper, and have included in Exhibit 1 our comments and suggested changes on the specific questions that were enumerated. In Exhibit 1 the *italicized* material sets forth the Board's questions, followed by our comments.

Thank you for your consideration.

Sincerely,

Carol Anthony Davidson

Senior Vice President, Controller and Chief Accounting Officer

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Exhibit 1:

The Board requests that constituents provide comments on the following questions:

1. Do you agree with the Boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

Discussion Paper ("DP") paragraph 2.23 states," A contract with a customer conveys rights to an entity to receive consideration from the customer and imposes obligations on the entity to transfer assets to the customer. The combination of the rights and obligations give rise to a single asset or liability depending on the relationship between the entity's rights and obligations."

We agree, in principle, with the proposal for a single revenue recognition model based on changes in an entity's net contact position. Any contract, whether explicit or implicit, creates rights, resulting from consideration promised by a customer, in exchange for an entity's obligation to transfer an asset or assets to that customer. This proposed revenue recognition model would more accurately reflect those rights and obligations compared to the current revenue recognition method. In practice, most revenue recognition issues require a diligent review of contracts to determine the rights and obligations that exist. A revenue recognition model based on this specific type of review could result in companies taking a more diligent approach to reviewing contracts. We also believe that this would reduce many inconsistencies in revenue recognition standards.

However, while we agree in principle, there are several concerns we feel the board must consider and address in any final standard. The proposed model could significantly impact long-term contracts currently recognized using percentage of completion accounting or another proportional performance based model of recognition (i.e. construction, services, software). The separation and tracking of performance obligations may not be practical in contracts which have many obligations or deliverables to a customer (i.e. construction contract) - See Question 5 for further discussion of concerns

We are concerned about completely eliminating the concept of transfer of risks and rewards as simple control and physical possession of an asset does not always equate the ability to obtain the benefits of that asset – See Question 8 for further discussion

Finally, while we agree a single standard will reduce many inconsistencies in revenue recognition, we believe that some of those inconsistencies in the current standards are necessary due to nuances within different industries, types of contracts, etc. These nuances should be addressed in any issued standard.

2. Are there any types of contracts for which the Boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

We believe scope exclusions should be based on the nature of the performance obligations and not the type of contract. For example, Asset Retirement Obligations and Guarantees are obligations to perform a type of service and are already covered by other authoritative literature. We believe that any performance obligation that is not related to a revenue contract, and is currently covered by non-revenue related authoritative literature should remain under the scope of that literature, and should be excluded from the scope of any final revenue recognition standard. (Refer to question 4 for further discussion related to Warranties.)

As noted in question 1, there could be significant impact on long-term contracts. For example, long-term construction contracts and software contracts could result in the deferral of revenue recognition until closer to completion of the contract. Additionally, contracts that provide for many deliverables or obligations potentially requiring separation could result in additional system requirements for companies in order to track and monitor each obligation separately.

We believe the Board should provide some additional guidance and discussion over the application of this proposed guidance to long-term contracts, specifically in the area of the transfer and satisfaction of performance obligations when they are satisfied over a period of time as opposed to at once. (See question 8 for further discussion.)

3. Do you agree with the Boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

DP paragraph 2.11 states, "A contract is an agreement between two or more parties that creates enforceable obligations"

Yes, we agree with the Board's proposed definition of a contract noted above. The definition is consistent with the "legal" definition of a contract. We believe the definition is sufficient to capture both written contracts and implicit contracts with customers by specifying an "agreement that creates enforceable obligation"

We are not aware of any jurisdictions in which it would be difficult to apply this definition

4. Do you think the Boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

DP paragraph 3.2 states, "An entity's performance obligation is a promise in a contract with a customer to transfer an asset (such as a good or service) to that customer."

We agree, in principle with the Board's proposed definition of a performance obligation, however, we believe that the definition is open-ended and some additional clarification should be provided, specifically to distinguish between a performance obligation associated with a revenue contract, and performance obligations associated

with other non-revenue related contracts which are currently covered by other authoritative literature.

We do not believe there would be any issue with a simple product delivery, however, when it relates to a service contract, or more specifically a long-term contract such as construction or software, it may become difficult to determine whether something is a performance obligation when the vendor considers the concept of services that are used up immediately by the customer. It is also not clear as to whether the definition is intended to capture any and all promises to the customer in the contract. For example, in a long-term construction type contract or software contract, there are many promises to the customer. In a software contract, there are many agreements to meet with the customer on a regular basis, periodically provide roadmaps, updates and corrections to user manuals, etc. Would each of these be considered separate performance obligations? Will there be some type of consideration of significance in the final draft?

We are not opposed to the inclusion of warranty obligation within a final standard on revenue recognition. We agree that this is an obligation to the customer to provide a service and can be viewed as a performance obligation. Additionally, we believe the proposed approach would provide more comparability between "free" warranties and warranties for which the customer separately incurs a cost.

However, we do not believe it would be practical or beneficial for the users of financial statements to measure this on an individual contract basis as a separate performance obligation. Consistent with current literature, we believe it to be more practical to measure and track this type of obligation for a large group of homogenous customers.

5. Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

Yes, we agree that an entity should separate the performance obligations in a contact on the basis of when the entity transfers the promised asset to the customer. We also agree with the statement in 3.27 that it would not be beneficial to separate performance obligations that are being delivered concurrently or in the same reporting period.

We do have some concern as to the application of the proposed guidance on separating performance obligations to a long-term construction type contract or a software contract requiring significant modification. We are not clear on how work-in-progress on this type of contract would be viewed based on the definition of a performance obligation and believe further clarification should be provided related to performance obligations that transfer to a customer over time. For example, a very labor intensive software contract or a construction contract with many promises and obligations within the overall contract. See question 8 for further discussion.

While we support a more principles based method of revenue recognition as discussed in the DP, we believe some guidance should be in a final draft to ensure consistency between companies and various contracts that could be similar although in different industries.

6. Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

No, we do not believe an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation. We believe this would be a cancellation of the previous transaction, or a failed sale as discussed in 3.39 as opposed to the execution of a performance obligation.

We agree that entity's need to consider the possibility of a customer returning goods and would not be opposed to the requirement being included within a final standard on revenue recognition, however, we have concerns around the practicality of application. Consistent with current practice, we believe an entity should estimate returns/refunds for a large group of homogenous customers, provided that there is sufficient historical evidence to reasonably estimate. We do not believe this should be done on an individual contract level as the tracking of this on an individual basis would not be practical and could require significant investment in upgrades to entity's IT systems.

We also have concerns as to how an entity would value a separate performance obligation related to the obligation to provide a refund based on the "estimated selling price concept" discussed in the DP. While valuation may be practical in a situation where there is a premium on the transaction price related to the right to a refund (i.e. a refundable plane ticket vs. a non-refundable ticket), we believe it would be difficult to value and track on an individual basis when no premium is associated with that right.

7. Do you think that sales incentives (for example, discounts on future sales, customer loyalty points, and "free" goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

No, we do not believe that the promise of sales incentives give rise to performance obligations. Consistent with the right to returns/refunds in the question above, we would not be opposed to the requirement to consider sales incentives at contract inception being included in a final standard on revenue recognition, however, consistent with current practice, we believe this should be done for a large group of homogenous customers provided that there is sufficient historical evidence to reasonably estimate. We do not believe this should be done on an individual contract level as the tracking of this on an individual contract basis would not be practical and could require significant investment in upgrades to an entity's IT systems.

8. Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

Yes. We agree, in principle, that an asset is transferred to a customer when the customer controls the promised good or when the customer receives the promised service. We agree that there are situations where control is transferred when possession of the good is retained, such as in a bill and hold situation.

However, we believe that any final draft should provide some additional clarification and specific guidance on the definition of 'control" and when control is transferred but physical possession has not. For example, if the customer was not the one that requested us to hold the product on our site, do they really have control over the assets?

We are also not sure how the proposed guidance would apply to construction contracts in which, based on the current guidance of SOP 81-1, the equipment was unique to the customer and included in the cost-to-cost allocation, but not physically delivered to the customer. While currently revenue would be recognized on this equipment as work progresses based on the cost to cost allocation, revenue may not be recognized under the proposed guidance because the asset has not physically been delivered to the customer and does not necessarily have control over that equipment. Additionally, what would the performance obligation be in this scenario? Would it be the obligation to build the equipment, which occurs over a period of time (several months or years) or the obligation to deliver the equipment to the customer once complete? There could be a significant difference in timing between when an entity would recognize revenue under current literature (SOP 81-1) vs. the proposed guidance in the discussion paper.

Similar to the situation above, for a contract to build a product for a customer (a ship) much of the construction and progress on the job may be handled in the vendor's warehouse and only transferred to the customer upon completion.

We believe that additional clarification and guidance is needed as it relates to the application of this proposed guidance to long-term construction type contracts and contracts involving software. The transfer of control or execution of performance obligations may be easy to determine in a product sale or a simple service that occurs over a short period of time, however, when services are provided over a longer period of time, the concept of control or the transfer of an asset to the customer is more difficult to determine.

For example, a labor intensive contract such as heavy modification or customization of software that occurs over a period of time. Is the performance obligation the obligation to customize and build that software to enable the customer to use it for its intended purpose? This would occur over a period of time and currently revenue is recognized as work progresses over that time using the guidance in SOP 81-1. Or is the performance obligation to deliver the final software product in which revenue would be recognized on a completed contract method as opposed to as the work progresses? When would "control" transfer to the customer. We do not believe a customer can control partially completed software.

9. The Boards propose that an entity should recognize revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

We agree with the principle that revenue should be recognized when a performance obligation is satisfied pending the final definition of a performance obligation. We agree that if multiple performance obligations are being satisfied concurrently, an allocation is not needed.

We do have some concerns over identifying performance obligation in a long-term construction type contract or a software contract where there may be many minor promises to a customer delivered over a period of time, as discussed above.

- 10. In the Boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.
 - a. Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

Yes, we agree, in principle, that performance obligations should be measured at the transaction price. We believe transaction price is the most objective and accurate representation of a balance between the economic substance of the transaction and fair value. We do not believe that any alternative method, such as fair value (based on exit price according to FAS 157), which could potentially include external data and assumptions in the analysis. We also believe there is a clear distinction between revenue based performance obligations and other performance obligations based on non-revenue contract that currently qualify under other authoritative literature such as AROs, contingencies and guarantees. While fair value may be appropriate in those types of contracts, we believe the transaction price is a more accurate representation in a revenue contract.

b. Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?

Yes. We believe that contracts should be re-measured if deemed onerous. We also agree that it may be beneficial to assess this at the performance obligation level when a contract with multiple performance obligations. However, we do have some concerns with application of this principle.

Some contracts are designed, especially when multiple elements are bundled, where a component of the contract may have a negative estimated margin, however, another component of the contract may have a positive estimated margin offsetting the negative margin and thus resulting in the entire contract becoming profitable. For example, consider an arrangement where equipment and a subsequent service are delivered, and are considered separate performance obligations of one contract. An enterprise may be willing to accept some "loss" on the obligation to deliver the equipment in order to obtain the customer and that ongoing service revenue, knowing that the ongoing service revenue will prevent the contract itself from being onerous.

Under the current literature, EITF 00-21 would ensure the proper recognition of revenue when value is transferred to the customer. It also prevents the opposite

from occurring; recognizing a contract with a large margin up front, while deferring the low margins over time.

Since any final standard would eliminate EITF 00-21, we believe the need to analyze contracts at a performance obligation level would eliminate the possibility of deferring obligations with a low or negative margin.

However, consistent with our prior comments, we have some concern as to the application in long-term construction type contracts with many performance obligations. We believe that a) it would be impractical to measure each performance obligation to determine if it is onerous, and would require significant investment in systems to enable the tracking and measuring of this and b) similar to the multiple element example above, the entire contract may be designed to turn a profit, however, certain minor performance obligations of that contract are not. We feel that additional consideration and guidance should be provided as to the application of this proposed guidance to long-term contracts.

We agree with the "cost trigger" concept in 5.62. 5.62 states "One way to identify onerous performance obligations would be to specify that a performance obligation is onerous when the expected costs to satisfy that performance obligation exceeds its carrying amount (that is, a cost trigger).

In principle, we agree that losses or anticipated losses should be recognized immediately, consistent with current accounting practice, however, as noted above, we have some concerns as to the practical application to long-term contracts which may possibly have a large amount of small performance obligations.

c. Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.

We agree in principle with the DP, however, consistent with our concerns above, we believe additional guidance and consideration is needed on the practical application to long-term contracts with potentially many small performance obligations.

d. Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

We agree that performance obligations should be initially measured at original transaction price; however, consistent with the above comments, we have some practical concerns. We believe some additional guidance and discussion should be provided on contracts of a long-term nature, such as construction type contracts. Currently, the proposal indicates performance obligations will only

be re-measured if deemed onerous. However, in long-term construction type contracts, several changes may occur to the contract, such as change orders and variations that could indicate that an amount in excess of the original transaction price should be recognized as revenue. How would these changes effect the measurement of the individual performance obligations?

- 11. The Boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (for example, selling costs) are included in the initial measurement of the performance obligations. The Boards propose that an entity should recognize those costs as expenses unless they qualify for recognition as an asset in accordance with other standards.
 - a. Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?
 - Yes, we agree that contract origination costs should be included in the initial measurement of an entity's performance obligations and allocated accordingly. These types of costs typically occur prior to the execution of the contract and, therefore, we believe it would be inappropriate to recognize revenue at that time.
 - b. In what cases would recognizing contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.
 - We agree with the recognition of origination costs as incurred. While we do not believe it would be appropriate to recognize a benefit of these costs as revenue immediately since the contract has not yet been executed, we do believe it would be appropriate to recognize the costs immediately as they have been incurred and would not be recovered should the contract not be executed for any specific reason.
- 12. Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's standalone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?
 - Yes, we agree, in principle that the transaction price should be allocated to the performance obligations on the basis of the entity's standalone selling prices of the goods or services underlying those performance obligations. Selling prices are typically the best reflection of the economic substance of a transaction and are generally derived after careful analysis of a company's costs.
- 13. Do you agree that if an entity does not sell a good or service separately, it should estimate the standalone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

Yes, we agree that an estimate of standalone selling prices should be made if a good or service is not sold separately provided that the concepts discussed in 5.48 remain in the final draft. Many accounting standards allow or require significant management estimates, we do not believe revenue recognition should be different.

Additionally, an estimate by management as to what they would sell the product for separately would best represent the economic substance of the transaction compared to an estimate of fair value based potentially on external factors and assumptions as the current guidance provides

There are many contracts in which it would be difficult to estimate selling prices for services that may never be sold separately, such as those in long-term construction contracts. We agree that an entity should be allowed to use various methods to estimate a standalone selling price, including a proportion of the expected cost plus a margin approach as discussed in the DP.