

1660-100 Comment Letter No. 134 5480 Corporate Drive, Suite 200, Troy, MI 48098-2641 Direct: 248.267.3700 • Fax: 248.267.3737 • Visit www.michcpa.org

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Financial Accounting Standards Board Attn: Technical Director—File Reference No. 1660-100 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

To Whom It May Concern:

The Michigan Association of CPAs' (MACPA) Accounting & Auditing Standards Task Force is comprised of member CPAs whose main objective is to review discussion papers and exposure drafts issued by the Financial Accounting Standards Board on behalf of our more than 17,000 members across the state.

The comments offered below on "Preliminary Views on Revenue Recognition in Contracts with Customers", while reflecting the thoughts of the members of this particular Task Force are developed with the entire Michigan CPA community in mind. It is our hope that you find them both insightful and helpful as you work to complete this project.

As requested, the comments provided by the Task Force are in direct response to the questions posed in the Discussion Paper. They are enumerated as such.

Chapter 2

Question 1: Do you agree with the Boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset of 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?

Yes. Since there is an enforceable agreement between the entity providing the services and the customer, there is a "meeting of the minds" of both parties. When a contract is entered into, both parties know each of their "performance obligations".

Question 3: Do you agree with the Board's 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.

Yes. The definition is simple and clear.

Chapter 3

Question 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 propose definition would in appropriately identify or omit deliverable in (or components of) the contract.

Yes. The contract spells out all of the performance obligations.

Question 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, if the entity can reasonably determine when the customer will received the goods or services (asset) and only if the separated performance obligations in the contract's life extend over multiple financial reporting periods. If they all take place within one period then there is no need to separate them.

Question 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?

We are split on this question. Some can accept the concept that the right of return is a separate performance obligation from the transfer of the asset and may have a quantifiable value which would allow the recording of separate transactions. But some also believe that the right of return is not a separate asset (thus not a separate performance obligation) but is a voiding of the original sale/transfer because the asset the customer received did not meet their expectations (promises made by the seller).

Question 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?

Yes. In theory, the customer is paying a portion of an obligation now for a service (or good) to be delivered at a future date. Therefore, based on historical data, such as the amount of coupons used vs. issued should have a portion of the revenue attached to the coupon.

Chapter 4

Question 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.

No. There are many circumstances in which an entity performs a service or constructs an asset in which a customer usually does not control the asset until it is substantially completed. One example of a service not being completed until a final report is issued is a CPA firm's audit of an entity.

Based on the current discussion paper, revenue would be recognized on a "completed contract" basis only, when control is situated with the customer. We think interim or yearly financial statements would provide inaccurate information to the readers of this entity's financial statements, if revenue was based on transfer of control (which in most cases is the physical possession of that good or service). The entity would see large swings in revenue from year to year which would depend when the entity's management completes the project or delivers the service. We think the Boards should revisit "percentage-of-completion" revenue recognition.

Question 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.

Yes. Please refer to the response to **Question #8**. Again, long-term construction accounting would produce widely fluctuating results if this new revenue recognition model was implemented. This could ultimately result in construction contracts being divided into a series of contracts which possibly would

get around this "customer controlled" asset issue. This also brings into question how an entity will finance these type projects ([which] financing institutions rely heavily on current financial results).

Chapter 5

Question 10: In the Boards' proposed model, performance obligations are measure 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. The performance obligations should be measured initially at the original contract price because this is the entity's best judgment of how the entity will make a profit on a normal (arm's length) transaction with a customer.

a.) Do you agree that a performance obligation should be deemed onerous and re-measured 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?

Yes. GAAP methodology was based on accountants being conservative. This principle also agrees to the practice in reviewing construction accounting estimates. Once a contract is underwater, the estimated loss should be recognized immediately by the entity. This assumes the general contractor is responsible for all contract overruns.

b.) 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.

No. Since accounting is moving from a "rules based system" to a "principles based system," there will have to be various judgments by the management(s) of entities to measure all performance based obligations. Even though it will be difficult at times to allocate a portion of revenues to the post-delivery of a good or service, there is historical information that can assist management in determining this allocation of revenues. For example, if there is a 30 day "right of return" for a full refund for a product, management probably knows how many returns there will be based on a prior customer history.

Question 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 than 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. The total costs that the customer will pay should be allocated to all performance obligations at the contract inception. This is consistent with the accounting theory and one standard should fit

all types of revenue recognition. If this principle is not followed, we will have numerous rules for all types of industries as we currently have.

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.

If there are extremely large amounts that are expensed as incurred at the end of one year for a specific proposal and a contract is agreed to in the next year and the amounts the entity wants to recover are included in the original contract price, they may be too much gross profit on that contract during the second year (since there is more revenue to be spread among the performance obligations).

Question 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. The standalone selling prices are the most objective price for allocation purposes.

Question 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. If the performance obligation is not completed by the end of a reporting period, management must use its judgment to allocate the revenue associated with a performance obligation that has been completed. An estimate may not be made if there is a question as to whether there is one or more than one performance obligations near the end of a reporting period. For example, some entities may want to claim there are two performance obligations when there is only one performance obligation (for the purpose of recognizing some revenue and profits before the end of a period...even though it is not clear that there is some part of the performance obligation that is not completed or extinguished.)

General Comments

The Task Force would like to stress the importance of considering how these proposed changes would affect the construction industry in particular; an industry that relies heavily on the percentage of completion. We believe that it would be a great burden on this industry to have a new GAAP method of revenue recognition that conflicts with the IRS required percentage of completion.

If the Financial Accounting Standards Board would like to contact the MACPA's Accounting & Auditing Standards Task Force in regard to these comments, please direct any inquiries to the MACPA Staff Liaison to the Task Force, John D. Lindley, at (517) 853-2560 or via e-mail at ilindley@michcpa.org.

Regards,

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