Educational Foundation

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Financial Accounting Standards Board Technical Director, File Reference No 1820-100 401 Merritt 7, P.O. Box 5116 Norwalk, CT 06856-5116

Via e-mail to: Director@fasb.org

RE: EXPOSURE DRAFT ISSUED JUNE 24, 2010 - PROPOSED ACCOUNTING STATEMENTS UPDATE - REVENUE RECOGNITION

Ladies and Gentlemen:

The Accounting Principles and Auditing Procedures Committee ("Committee") is the senior technical committee of the Massachusetts Society of Certified Public Accountants. The Committee consists of members who are affiliated with public accounting firms of various sizes as well as members in both industry and academia. The Committee has reviewed and discussed the above-mentioned proposal. The views expressed in this comment letter are solely those of the Committee and do not reflect the views of the organizations with which the Committee members are affiliated.

RESPONSES TO SPECIFIC EXPOSURE DRAFT QUESTIONS

Question 1 - Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether to:

- (a) combine two or more contracts and account for them as a single contract;
- (b) segment a single contract and account for it as two or more contracts; and
- (c) account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

The Committee generally agrees with the principle.

In practice it may be difficult to make a meaningful determination of when to combine contracts, segment them or account for as modification as a new contract. Contract provisions which would address such determinations may not always be included in the contract. Additional guidance is necessary to help users where a legal interpretation results in one conclusion and an economic interpretation results in a different conclusion.

The Committee suggests that an additional indicator be added to paragraph 13 to reflect when payment on individual contracts is dependent on performance under all contracts.

Question 2 - The Boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

The Committee agrees with the principle.

Question 3 - Do you think that the proposed guidance in paragraphs 25–31 and related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

The Committee generally agrees with the proposed guidance.

However, the guidance may be insufficient, or even inappropriate, where services are concerned. Contract terms involving transfers of goods are generally easier to interpret and progress on performance is more visible. This may not be the case where performance of services is concerned. The guidance may also be insufficient where construction contracting and subcontracting is concerned. Control may not always be the sole distinguishing factor in determining whether or not to recognize revenue. A contractor for the construction of a building may complete the transfer of some deliverables. However, nothing less than completion of all promised deliverables will result in the passing of a true level of control to the owner. This only occurs when an occupancy permit is received. Furthermore, the extent to which a buyer is directing or not directing in continuously delivered manufacturing or construction is a matter of degree and open to much interpretation. Secondly, there may be many cases in practice where the degree of legal control differs from the degree of economic control. Perhaps the guidance should indicate which is to be favored and what factors should be weighed in decision making.

The Committee feels clearer implementation guidance is needed particularly with regard to long-term construction contracts and the service contracts.

Question 4 - The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?

The Committee generally agrees that revenue should be recognized on the basis of a reasonably estimated transaction price. However, the use of a probability-weighted methodology for determining the amount to assign to contingent consideration could be cumbersome at best, but more likely impossibly difficult in practice. This would be especially true in industries where revenue consists of millions of relatively small transactions. The Board should consider offering a more practical approach.

The Committee is further concerned how paragraph 38 if adopted will apply to newly engineered products or services with no previous entity experience.

Finally, the Committee is confused as the reference in the first sentence of paragraph 40 of "the above factors". Does this reference refer to the factors in paragraph 38 or 39 or both?

Question 5 - Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue? If not, why?

The Committee does not agree that the transaction price should reflect the customer's credit risk. The Committee believes the amount recorded as revenue should be the amount per the contract. The credit risk should be accounted for as a separate cost of doing business.

Question 6 - Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

The Committee agrees with this proposal. The exposure draft provides insufficient guidance in determining when it is implicit in a contract that a financing component exists. Implementation guidance should include clear examples to illustrate the proposal.

Question 7 - Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

The Committee agrees with this proposal.

Question 8 - Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, Topic 330 or IAS 2; Topic 360 or IAS 16; and Topic 985 on software or IAS 38, Intangible Assets), an entity should recognize an asset only if those costs meet specified criteria.

Do you think that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient? If not, why?

The Committee is divided on this question.

Some of the members of the Committee agree with this guidance.

Some of the members of the Committee disagree with this guidance. Those members of the Committee believe that costs of obtaining a contract should be accounted for as an asset if the result of incurring the costs is a successful acquisition of a contract.

Question 9 - Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

The Committee agrees with the costs specified: direct labor, direct materials, allocation of costs (i.e. overhead), contract costs chargeable to customer, and other costs incurred by contractor exclusively for contracts. The Committee feels that these costs are all-inclusive and would cover any type of costs incurred in a contract.

However, recognition of liabilities may result in unintended consequences where for, example, a contract includes a bundle of performance obligations and one or more such obligations is discounted for marketing purposes.

Question 10 - The objective of the Boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

The Committee believes the qualitative disclosures would be helpful to users of financial statements. However, the Committee does not believe the quantitative disclosures would be helpful. Moreover, the proposed quantitative disclosures could be overwhelmingly difficult to prepare and understood in all but the simplest of situations.

Questions 10, 11 and 12 each asks whether a specific aspect of the disclosure requirements would be useful to readers. The Committee believes that the utility of the disclosure will vary based on the nature, size and complexity of the reporting entity. Our concern is whether or not the value of the disclosures will exceed the cost to assemble and audit the data for small entities. It is possible small entities do not keep records that will enable them to present disaggregated revenue by amounts, timing and uncertainty of revenues and cash flows and how they are affected by economic factors. Or, that such data will be susceptible to sufficient auditing procedures.

The disclosure requirements also include the presentation of reconciliations of certain information. Presumably, such reconciliations would be prepared as part of the entity's ongoing accounting, but the Committee wonders how valuable such reconciliations are to users of the financial statements. Again, relating this to experience with small entities, I have yet to see any remarkable information presented as part of the reconciliation of the fair value of level 3 assets.

Question 11 - The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

The Committee generally agrees with the proposed requirement to disclose the amount of remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year. This should be done where it is practical to do so. Where it is not practical, the reasons why should be given.

The Committee again raises the concern as to value of portions of this disclosure as detailed under Question 10. Please refer to the Committee response under Question 10.

Question 12 - Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

Please refer to the Committee response under Question 10. This disclosure should be limited to those entities required to report segment data.

Question 13 - Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

The Committee believes a retrospective treatment is desirable so that proper year-to-year comparisons can be made. However, there may be many instances where re-computing revenue recognized in prior years is not possible or is cost-prohibitive. This retroactive treatment could be an extreme burden to entities. The additional costs of implementing this retroactively would outweigh the benefit for users. The guidance should recognize this reality and provide a transition alternative where this is the case.

The Committee suggests that the new standard be applied to new contract entered into or after the effective date of the new standard. The Committee further suggests that adequate disclosure with regard to how revenue recognition is accounted for should be required for all contracts entered into before the effective date of the new standard.

Question 14 - The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance. Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

Please see various responses as put forth above and below.

<u>Question 15 -</u> The Boards propose that an entity should distinguish between the following types of product warranties:

- (a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.
- (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

The Committee feels that the proposed approach is useful but complex and confusing. The Committee suggests more examples be set forth to demonstrate the approach.

Question 16: The Boards propose the following if a license is not considered to be a sale of intellectual property:

- (a) if an entity grants a customer an exclusive license to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the license; and
- (b) if an entity grants a customer a nonexclusive license to use its intellectual property, it has a performance obligation to transfer the license and it satisfies that obligation when the customer is able to use and benefit from the license.

Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the patterns of revenue recognition proposed by the Boards? Why or why not?

The Committee does not agree with the proposal.

A basis for different accounting based on whether non-controlling rights are exclusive or non-exclusive is not justified. The seller's obligation is to transfer rights to use in both instances. The Committee thus believes the revenue should be recognized at the time of the transfer in both instances.

Question 17 - The Boards propose that in accounting for the gain or loss on the sale of some nonfinancial assets (for example, intangible assets and property, plant, and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why

The Committee agrees with this proposal.

Question 18 - Should any of the proposed guidance be different for nonpublic entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?

The Committee believes that, for not-for-profit organizations, the proposed guidance for revenue recognition would not be applicable when the contract is a grant contract rather than a quid pro quo (i.e. exchange) contract. If the contract is of a grant type, then the revenue is to be recognized when the donor makes the intention to fund the costs of the contracts. However, if it is of an exchange type and the customer is funding the costs with the expectation of receiving a direct benefit, it would fall under the proposed guidance in this exposure draft and should be treated similarly from an accounting perspective.

The Committee with regard to small and medium entities believes that many of the provisions in the exposure draft are not possible for smaller, non-public entities because they rely on accounting software that cannot be modified to accommodate such provisions. Specifically, mid-level and low-level software is not designed to perform the following tasks necessary for adoption:

- Combining and segregating contracts
- Separating contracts into various performance obligations and assigning values
- Recording when certain performance obligations of contracts have been met when others have not.
- Reducing transaction prices for collectability, implicit financing components, receiving non-cash consideration and consideration payable to the customer
- Presenting contract assets and liabilities separate from accounts receivable

Paragraphs BC239 through BC247 discuss cost-benefit considerations. Specifically, paragraph BC246 indicates the Board has consulted users and preparers across a wide range of industries and jurisdictions. The Committee recommends that the Board specifically consult privately owned companies who generally operate on software and hardware systems much less robust than those

operated by larger, publicly owned companies. The Board has evaluated the cost-benefit consideration across various industries. The Board should also evaluate the cost-benefit across various sized businesses. In doing so, the Board should be mindful of what accounting systems are simply not capable of doing.

The Committee once again refers to its comment set forth under Question 10 that states the value of this information to small and medium sized clients.

The Committee expresses a very large concern of how a public accounting firm can assist its small and medium sized plus not-for–profit client in implementing this proposal and maintaining the accounting firm's independence with regard to these clients.

The practical side to implementing this proposal on nonpublic and not-for profit entities is that the time period for implementation could be lengthy and costly.

CONCLUSION

Please see our various comments as detailed above.

The Committee recommends very strongly that all references to long-term construction contracts should be removed from this proposal. The Committee further strongly recommends that long-term construction contracts be granted a temporary scope exception from the provisions of this proposal. The Committee is concerned about the adverse effects this proposal will have on long-term construction contracts. It is the feeling of the Committee that more time and thought is needed as to the effects of this proposal on these contracts and thus requests the above removal of the references and the granting of a temporary scope exception.

The Committee feels that by proceeding with these two actions that the FASB and IASB could then set a separate project agenda dealing with these contracts, solicit revenue recognition input specific to these contract and either decide to leave the present revenue recognition methods in place or put forth a thoughtful proposal dealing with revenue recognition on long-term construction contracts.

Thank you for allowing us the opportunity to comment on this proposal.

Very truly yours.

Philip B. Pacino, CPA, Chairman

Accounting Principles and

Auditing Procedures Committee

Massachusetts Society of Certified Public Accountants