

October 22, 2010

FASB Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 1820-100

Dear FASB Technical Director:

We are pleased to comment on the Proposed Accounting Standards Update (ASU), *Revenue Recognition (Topic 605): Revenue from Contracts with Customers* (the “proposed ASU”). Overall, we support the efforts of the Financial Accounting Standards Board and the International Accounting Standards Board (the “Boards”) to provide a single source of comprehensive guidance on revenue recognition. In addition, while we support the overall direction of the project, we have some significant concerns, including the following:

- **Segmentation of a Contract** (Question 1) – We believe the additional step of determining whether a contract should be segmented causes unnecessary complexity in the revenue recognition model in the proposed ASU. This step appears to be primarily addressing a somewhat narrow issue, being those situations in which changes in a transaction price truly relate to a single performance obligation rather than all performance obligations in a contract (and therefore should only be allocated to that single performance obligation). We suggest that this step be replaced with some targeted guidance that explains the criteria to utilize when evaluating whether changes in a transaction price should only be allocated to a single performance obligation rather than all performance obligations in a contract.
- **Distinct Good or Service** (Question 2) – We believe it would be helpful to clarify some of the language used to describe a good or service that has a distinct function. It is currently unclear whether this must be evaluated from the perspective of the entity or the customer. Furthermore, we believe additional implementation guidance regarding the determination of whether a good or service has a distinct profit margin would also be helpful.
- **Transfer of Control of a Promised Good or Service** (Question 3) – We do not believe the guidance in the proposed ASU is sufficient for many services transactions and long-term construction contracts. We recommend, at a minimum, that additional indicators be included specifically for services transactions to determine when control of the service is transferred, as well as some more detailed services transaction and long-term construction contract examples. Furthermore for long-term construction contracts, we are not sure whether the reported information will be decision-useful for users of financial statements of those entities that currently recognize revenue throughout a contract term but will have to defer recognition of all revenue until final delivery in situations where control of the underlying asset in the contract does not transfer continuously over the contract term.

- **Collectibility** (Question 5) – We do not believe that the proposed classification of changes in the assessment of credit risk as income or expense rather than as revenue once a receivable has been recorded will be operational for preparers in certain cases. Furthermore, we do not believe this treatment is consistent with other changes to items considered in determining the transaction price.
- **Retrospective Application** (Question 13) – We believe that application of the proposed ASU on a full retrospective basis would be overly burdensome for preparers. We suggest a modified retrospective transition approach that requires retrospective application beginning with contracts entered into after the ASU is finalized.
- **Rights of Return** – We believe it would be helpful to include additional implementation guidance addressing product returns in which the amount refundable for each returned product differs from the transaction price allocated to the product. Furthermore, we believe specific guidance should be added to address the accounting treatment for refundable service fees.

These concerns are discussed in further detail in the remainder of our response below, along with other comments and suggestions for your consideration on certain of the discussion questions on which specific comment is sought and other matters.

Comments on Discussion 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 would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

We agree with the overall principle of using price interdependence when evaluating whether multiple contracts should be combined and accounted for as a single contract. This concept is very similar to the existing guidance in U.S. GAAP for software transactions (ASC 985-605-55-4) and seems to generally work well in practice today. Furthermore, we agree with using the price interdependence principle when determining the appropriate accounting for contract modifications.

We are concerned, however, with the price independence principle when evaluating whether a single contract should be segmented into multiple contracts. It is unclear to us how the price of one performance obligation in a contract could ever be considered truly independent of the price of other performance obligations in that same contract. In evaluating whether individual prices could be independent, we would have expected that one would have to look to the inverse of the indicators included in paragraph 13 for interdependent prices (rather than evaluating the items noted in paragraph 15) which are:

- (a) the contracts are entered into at or near the same time;
- (b) the contracts are negotiated as a package with a single commercial objective; and
- (c) the contracts are performed either concurrently or consecutively.

If the evaluation of independence was done based on the inverse of the above criteria, we would expect that indicators (a) and (b) would never be met as the performance obligations are in the same contract while indicator (c) may or may not be met depending on the circumstances. We would

therefore expect that the price of one performance obligation in a contract would never be independent of the price of other performance obligations in that same contract.

Furthermore, in addition to concern over the criteria used to determine independence for segmenting purposes, we question whether segmenting should be part of the model when identifying the unit of account at all. Our view is that this guidance seems to be primarily included as one of the steps in the model to address a somewhat narrow issue, being those situations in which changes in a transaction price truly relate to a single performance obligation rather than all performance obligations in a contract (and therefore should only be allocated to that single performance obligation). We believe this additional step creates unnecessary complexity in the revenue recognition model. This scenario could be better addressed through some targeted guidance that explains the criteria to utilize when evaluating whether changes in a transaction price should only be allocated to a single performance obligation rather than all performance obligations in a contract. Alternatively, if segmentation remains as part of the revenue recognition model, we suggest that the final guidance state specifically when this step would need to be applied so entities do not have to unnecessarily evaluate segmenting in every contract.

Finally, as one point of clarification regarding segmentation, we noted that the language in paragraph 15(a) on segmenting differs from that of paragraph 23(a) on distinct goods or services, as the term “regularly” is included in the former paragraph but not the latter. We believe that since these concepts are similar the language should be conformed in both sections. If this difference in language was intentional, we suggest that in the final ASU further explanation be included in the Basis for Conclusions as to why there is this particular difference in wording.

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?

Overall, we agree with the principle for determining when a good or service is distinct but have some concerns regarding the clarity of the principle as well as its application. We believe it would be helpful to clarify some of the language used to describe a good or service that has a distinct function. For example, it is currently unclear whether this must be evaluated from the perspective of the entity or the customer. We presume that since paragraph BC52 states that the “value to the customer on a standalone basis” terminology that exists currently in U.S. GAAP was not used in the proposed ASU given the difficulty in knowing a customer’s intentions, that the distinct function of a good or service should be evaluated from the perspective of the entity. With that said, we believe this should be explicitly stated in the final guidance somewhere other than the Basis for Conclusions.

Furthermore, the proper application of the guidance in paragraph 23(b)(i) that describes a good or service that has a distinct function is unclear to us in certain situations. It appears that a good or service could be considered to have a distinct function if:

1. It has utility on its own;
2. It has utility together with other goods or services that the customer has acquired from the entity; or
3. It has utility together with other goods or services that are sold separately by the entity or another entity

In a situation whereby preceding items 1 and 3 are not met, it would seem that every good or service would meet item 2 and therefore be considered to have a distinct function. To explain further, we would think that a good or service that has no utility on its own, and no utility with other goods or services sold separately, must have utility when considered together with other goods or services that the customer has acquired from the entity (presumably the other goods or services included in the

contract) or else no customer would purchase them. With that said, we believe that this was not the intended outcome considering that Example 10 in the implementation guidance implies that when evaluating whether a good or service has a distinct function, one cannot consider its utility with other goods or services purchased in the same contract. In that example, the conclusion is that the license doesn't provide utility together with other goods or services that the customer has received from the entity, even though we believe the license must have utility when considered with the R&D services sold in the same contract. As a result, we believe the guidance in paragraph 23(b)(i) should be modified to state the following (changes in *italics*):

“it has a distinct function—a good or service has a distinct function if it has utility either on its own or together with other goods or services that the customer has acquired from the entity (*in prior contracts*) or are sold separately by the entity or by another entity; and”

We also believe it would be helpful to include additional implementation guidance regarding the determination of whether a good or service has a distinct profit margin. Currently, the proposed ASU defines a good or service with a distinct profit margin as one that is subject to distinct risks. We believe further guidance is needed on the term distinct risks which may best be illustrated through an example. In addition, we believe it should be explicitly stated as to whether two different goods with the same profit margin could be considered to have a profit margin that is distinct.

Finally, although we agree with the overall principle in regard to identifying performance obligations, we expect that the inherent subjectivity in determining performance obligations will likely lessen the comparability of financial statements as different entities may identify different performance obligations in similar circumstances.

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?

We believe the guidance included in the proposed ASU for determining when control of a promised good or service has been transferred to a customer is sufficient for many product sales. However, we have significant concerns in regard to the sufficiency of the guidance for many services transactions and long-term construction contracts. For example, of the four indicators included in paragraph 30 for determining whether a customer has obtained control of a service, two are not relevant as stated in paragraph 31 (e.g., the customer has legal title and the customer has physical possession). The remaining two indicators are not often particularly persuasive in the context of many services transactions. In other words, we believe the recognition of revenue from services transactions should occur based on more than just whether the customer: (a) has an unconditional obligation to pay and (b) specifies the design or function of the service. So for services contracts, the proposed ASU only includes a principle for when a customer obtains control of the service, two indicators of when control is transferred that are often not very persuasive and two examples of control transfer in the implementation guidance. Given the significance of services transactions, we believe that additional guidance is necessary and would recommend at a minimum that additional indicators be included specifically for services transactions to determine when control of the service is transferred as well as some more complex service transaction examples in the implementation guidance. Without additional guidance, we believe there will be significant diversity in practice among preparers when this guidance is implemented.

In regard to long-term construction contracts, we understand that revenue can only be recognized when control of the related good or service has transferred to a customer similar to all other contracts. However, we think that this principle must be defined more thoroughly for these contracts. We also believe that more detailed examples of the application of this guidance for long-term construction contracts should be included in the implementation guidance. These examples should illustrate the

Boards' thought process regarding when control transfers and when a contractor is considered to have satisfied their performance obligations, as this is currently unclear.

Furthermore, we remain concerned about whether the reported information will be decision-useful for users of financial statements of those entities that currently recognize revenue throughout a contract term but will have to defer recognition of all revenue until final delivery in situations where control of the underlying asset in the contract does not transfer continuously over the contract term. While we are unsure as to how pervasive this situation may be, we do suspect it will occur often and think that financial statement users will not find the result decision-useful. While we agree it is consistent with a contractual assets and liabilities approach to revenue recognition, we recommend that the Boards attempt to find a resolution that would allow for revenue on these types of long-term contracts to be recognized over the performance period as opposed to being deferred until final delivery. In determining a resolution, we believe the Boards should further consider whether they believe the accounting for two long-term construction contracts that are exactly the same economically and substantively should differ solely due to contract terms that differ in regard to whether the customer obtains control over the term of the contract or at the end of the contract.

Furthermore, regarding the overall concept of transfer of control of a good or service, we believe that there should be an indication of the relative importance of each of the indicators in the determination of whether control of a good or service is transferred. In addition, we believe that further guidance is necessary regarding the concept of the continuous transfer of goods or services and how the indicators specifically relate to this concept.

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?

We agree that an entity should recognize revenue on the basis of an estimated transaction price and the proposed criteria in paragraph 38. However, the Boards should be aware that this could result in significant volatility in entities' income statements and users may not find this type of volatility particularly decision-useful.

Furthermore, although we agree with this overall premise, we believe reference should be made to "access to the experience of other entities if it has no experience of its own" in paragraph 38(b) (as well as paragraphs 39 & 39(c)) in order to be consistent with the guidance in paragraph 38(a). Our proposed modifications in these paragraphs are as follows (changes in *italics*):

38(b) "the entity's experience is relevant to the contract because the entity does not expect significant changes in circumstances (*or the experience of other entities is relevant to the contract because there are not significant differences in circumstances between the entity's contracts and the contracts of the other entities*)."

39 "Factors that reduce the relevance of an entity's experience (*or the experience of other entities*) include the following:"

39(c) "the entity's experience (*or the experience of other entities*) with similar types of contracts is limited; and"

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?

We 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. However, we do have concerns with the guidance in the proposed ASU regarding changes in the assessment of credit risk being recognized as income or expense rather than as revenue once a receivable has been recorded.

We believe the classification of changes in assessment of credit risk as income or expense will cause unnecessary complexity in the model and is not consistent with the treatment of certain other subsequent changes in transaction price (such as variable consideration). For example, when discussing subsequent changes in transaction price in paragraph BC86, the Boards noted that they rejected presenting changes in estimates of a transaction price as a gain or loss separately from revenue because "...the total amount of revenue recognized for the contract would not equal the amount of consideration received from the customer." Furthermore, in paragraph BC87, "...the Boards decided that an entity should allocate a change in the transaction price to all performance obligations in the contract *because the cumulative revenue recognized would depict the revenue that the entity would have recognized if, at contract inception, it had the information that was available at the subsequent reporting date.*" (*italics added*). It is unclear why this same logic would not apply when considering changes in the assessment of credit risk. In other words, by presenting changes in collectibility as income or expense: (1) the total amount of revenue recognized would not equal the amount of consideration received from a customer and (2) the cumulative revenue recognized would not depict the revenue recognized if, at contract inception, the entity had the information on collectibility that was available at the subsequent reporting date. This is exactly the result the Boards rejected when considering other changes in transaction price.

If this principle regarding the treatment of subsequent changes in the assessment of credit risk once a receivable has been recorded is maintained in the final ASU, we believe additional guidance will be required. For example, it is unclear to us whether the proposed ASU would require entities to estimate collectibility for each individual performance obligation within a contract. Whether this is required or not could have a significant effect on the income statement classification of changes in the assessment of credit risk. Consider the potential impact in situations in which an entity has multiple performance obligations in a contract that are delivered over time and payment is due at various points throughout the contract. For example, assume an entity has a contract to deliver two products, product A on April 30 and product B on June 5 for \$100 each (which equals their estimated selling price). Payment is due for each product 30 days after delivery. At inception, the entity estimates the transaction price to be \$180 (\$200 stated price less a \$20 reduction for credit risk). Both products are delivered as scheduled and the entity receives a \$100 payment for product A on May 30 but only \$80 on July 5 for product B. On a contract-level basis, the entity's estimated transaction price equaled the consideration received from the customer of \$180. If the entity must assess collectibility at a contract level, then they would simply recognize \$180 as revenue and no income or expense.

However, based on a literal application of the principle we would think that when the entity received the initial \$100 on May 30 for product A, they would be required to update their assessment of collectibility. Assuming they expected to receive \$90 each for both product A and B initially, and because the entity had an unconditional right to receive \$100 for product A after delivery on April 30, we would think the entity would be required to record \$10 of the \$100 received on May 30 as income rather than revenue. Furthermore, the entity should evaluate collectibility of the remaining \$100 that will be due 30 days after product B is delivered at that point. Since as of May 30 the entity did not have an unconditional right to receive \$100 for product B (since it had yet to be delivered), any changes in the assessment of collectibility for product B would affect the transaction price (and

ultimately revenue). Consider the following three scenarios regarding the updated assessment of collectibility:

1. Entity believes they will only collect an additional \$80 (same \$180 total as originally expected)
2. Entity believes they will collect an additional \$90 as originally expected for product B (\$190 total consideration)
3. Entity believes they will collect an additional \$100 (\$200 total consideration)

If the entity only collected an additional \$80 consistent with the original example, the ultimate classification of the total \$180 received for this contract in each of the above scenarios would be as follows:

1. Record \$170 of revenue and \$10 of income (\$90 of revenue and \$10 of income from product A, \$80 of revenue from product B)
2. Record \$180 of revenue, \$10 of income and \$10 of expense (\$90 of revenue and \$10 of income from product A, \$90 of revenue and \$10 of expense from product B)
3. Record \$190 of revenue, \$10 of income and \$20 of expense (\$90 of revenue and \$10 of income from product A, \$100 of revenue and \$20 of expense from product B)

As illustrated above, the results could significantly differ depending on whether this evaluation must be done at a performance obligation or a contract level. While we believe the performance obligation model is consistent with the principles of the proposed ASU, it seems impractical.

In addition to this scenario, we believe there will also be potential implementation issues in situations in which performance obligations in a contract are delivered at different times and the related revenue recognized differs from the timing of the related payments. In these situations, we believe questions will arise regarding subsequent changes in collectibility and whether those changes relate to performance obligations that have already been delivered (and therefore classified as income or expense) or performance obligations that have yet to be delivered (and therefore classified as revenue).

If this guidance from the proposed ASU is retained in the final ASU, we would also recommend explicitly stating whether changes in the assessment of credit risk should be recorded as part of operating income or as other gains and losses.

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?

We agree 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. However, we believe additional guidance or examples may be helpful. For example, when evaluating materiality, it is unclear whether the evaluation should be based on materiality of the financing component in comparison to the individual contract or all of the entity's contracts. In addition, we believe an example further illustrating this guidance in contracts with several products or services delivered over time and payment terms at varying points over the life of the contract would be helpful.

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?

We agree 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. However, there is very little guidance included to help determine how to estimate a selling price. We recommend that additional proposed estimation methods be added to paragraph 52 along with additional examples of more complex situations, such as those relating to common performance obligations that are distinct but very rarely sold separately (e.g., software licenses).

We also note that paragraph 52 proposes that “an entity shall maximize the use of observable inputs” when estimating standalone selling prices and the first suitable estimation method is the expected cost plus a margin approach. While we agree that an expected cost plus a margin approach may be appropriate, we are concerned with use of the phrase “observable inputs.” Observable inputs are defined in the Master Glossary of the Codification as “inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity.” This term is typically used in the context of fair value measurements. Because this section of the proposed ASU doesn’t require fair value to be determined for the goods and services, we believe the term “observable inputs” should be removed. This is further supported by the fact that an expected cost plus a margin approach clearly is not based on observable inputs using the Master Glossary definition.

Furthermore, we note that paragraph BC125 states that a residual method should not be used to allocate the transaction price to separate performance obligations. This is consistent with the principles of allocation using a relative standalone selling price basis noted in the proposed ASU. However, paragraph BC125 continues on, stating, “...However, the Boards noted that a residual (or reverse residual) technique may be an appropriate method for estimating a standalone selling price if there is a directly observable price for one performance obligation but not the other.” It is unclear to us why the Board would reference use of either the residual or reverse residual methods as potentially being appropriate to estimate a standalone selling price. Inherent in these methods is that the amount allocated to one performance obligation in a contract is based on the standalone selling price of the other performance obligations. It would seem that since the principle of estimating a standalone selling price is to determine the price at which a performance obligation would be sold without any other performance obligations in a contract, there would be no way to meet that principle through the use of the standalone selling prices of other performance obligations as would be done in a residual or reverse residual method. We suggest that any reference to the residual or reverse residual method as being an appropriate method for determining an estimated standalone selling price be removed.

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?

We generally believe that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient. However, it is unclear to us why there is a reference in paragraph 57(a) to costs related directly to a specific contract under negotiation being eligible for capitalization. There is no other discussion in the proposed ASU regarding this concept of costs related to specific contracts under negotiation. In all other sections of the ASU in which the capitalization of costs is referenced, (including Question 9 below and paragraph 58) reference is only made to a “contract” and not “a specific contract under negotiation.” If the Boards intention was to allow these costs to be eligible for capitalization, then we believe there should be further discussion as to why these types of pre-

contract costs are eligible for capitalization and how they should be tested for impairment prior to obtaining the 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?

We believe that only incremental costs directly related to a contract should be considered when determining whether a liability should be recognized for an onerous performance obligation. If non-incremental costs are included in this evaluation, we believe there may be unintended consequences in which the signing of an otherwise profitable contract could result in a day one onerous performance obligation. For example, an entity may enter into a low margin contract (when considering just the incremental costs to be incurred) in situations in which they currently have fixed labor with excess capacity. When considering other costs like the allocation of direct labor costs which are fixed, the present value of these probability-weighted costs may be in excess of the performance obligation's allocated transaction price and a liability would be required to be recorded under the proposed ASU. However, if the entity didn't sign this contract, those same fixed labor costs would simply be recognized as an expense as incurred. As we believe this result doesn't reflect the economics of this type of a transaction, we believe only the incremental costs should be considered when determining whether there is an onerous performance obligation.

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.

We believe that application of the proposed ASU on a full retrospective basis would be overly burdensome for preparers. For example, public companies would have to apply the guidance for the four years prior to adoption for purposes of selected financial information disclosures. As an alternative, we suggest a transition approach that would allow preparers to gather and track the information necessary to apply the final ASU on a real-time basis rather than having to recreate all of the information from prior years. One way to do this would be to require a modified retrospective transition approach. The approach we would propose is to require retrospective application only beginning with contracts entered into after the ASU is finalized. For example, if the ASU is finalized on June 30, 2011, we would propose that when applying the retrospective approach, it would apply to contracts entered into in fiscal years beginning after June 30, 2011. This would allow companies to avoid having to recreate information for purposes of adopting the ASU, such as best estimates of selling price. Furthermore, this would not be nearly as burdensome as requiring a full retrospective approach and still provide comparability of information to the prior year.

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?

We included most of our views on areas where we believe additional implementation guidance is necessary in response to the other questions as well as in our "Other Comments" at the end of this letter. However, we want to note in response to this question that it seems there are a significant number of principles in the proposed ASU that are very similar to current U.S. GAAP but substantially briefer (e.g., principle versus agent considerations, nonrefundable upfront fees, bill-and-hold arrangements, customer acceptance etc.). While we understand the need for the guidance not to be

overly prescriptive, we are concerned that for these topics the brevity of the guidance may result in a lack of consistent application in practice between U.S. GAAP and IFRS (even if the words are exactly the same). We believe this may occur because U.S. GAAP preparers are likely to look to superseded U.S. GAAP for further interpretations while IFRS preparers may not. To avoid this potential lack of consistency, we recommend adding further implementation guidance based on existing U.S. GAAP in those areas where the principles in the proposed ASU are very similar.

Question 15: 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?

We generally agree with the proposed distinction between the types of product warranties and the related proposed accounting. However, we believe it will be difficult in certain cases to distinguish between these two types of warranties based on the proposed guidance. For example, it is unclear whether a 36 month warranty on a car would be considered a warranty for coverage for latent defects in the product (“quality assurance warranty”) or for coverage for faults that arise after the product is transferred (“insurance warranty”). We believe additional implementation guidance should be added to address this issue in these and similar circumstances.

Furthermore, we have concerns related to quality assurance warranty scenarios in which an entity is not required to replace an entire product but is only required to repair or replace a component of the product. Paragraph IG15 states that the transaction price attributed to the product’s components should be deferred. However, components within a product would not be considered performance obligations and therefore the transaction price would not be allocated originally to components of a product, but rather the entire product itself. As a result, entities will have to determine the transaction price to allocate to an item that does not meet the definition of a performance obligation. This could cause some implementation difficulties for entities and we recommend that an example addressing this situation be added to the implementation guidance.

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?

Based on the guidance, it is not entirely clear why the exclusivity of a license should be one of the determining factors in whether revenue is recognized on delivery of a license as compared to over the

license's term. We suggest that the Boards add further clarification as to the thought process regarding including exclusivity of a license as a determining factor in the timing of revenue recognition.

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?

We agree that an entity should apply the recognition and measurement principles of the proposed ASU in accounting for the gain or loss on the sale of some nonfinancial assets. We see no valid reason why there should be different recognition and measurement principles for transactions depending on whether an entity classifies those transactions as gains or losses (outputs from other than ordinary activities) as compared to revenue (outputs from ordinary activities).

Other Comments

Scope

In cases where a contract includes performance obligations within the scope of the proposed ASU and outside of its scope, paragraph 7 states that an entity shall first apply the separation and measurement requirements of the other Topics if those other Topics specify guidance. We suggest that the guidance in this paragraph be modified to specifically identify those other Topics that include separation and/or measurement requirements.

Identifying the contract

1. A contract is defined in Appendix A as an agreement between two or more parties that creates enforceable rights/obligations. However, paragraph 8 states that an entity shall apply the proposed guidance to each contract as identified in accordance with paragraphs 9-19. Those paragraphs state that a "contract" could actually be several contracts combined or segmented portions of a contract. We do not believe that a segmented or combined "contract" as identified in paragraphs 9-19 would meet the definition of a contract as stated in Appendix A. To address this issue, we suggest either modifying the definition of a contract in Appendix A to conform with the guidance in paragraphs 9-19 or changing the terminology from "Identifying the contract" to "Identifying the unit of account" immediately prior to paragraph 8 and throughout the proposed ASU.
2. Paragraph 9 proposes that a contract can be implied and paragraph 10 goes on to propose that the following four criteria must be met for a contract to exist:
 - (a) the contract has commercial substance;
 - (b) the parties to the contract have approved the contract and are committed to satisfying their respective performance obligations;
 - (c) the entity can identify each party's enforceable rights regarding the goods or services to be transferred; and
 - (d) the entity can identify the terms and manner of payment for those goods or services.

It is unclear to us how an implied contract could ever meet all four of these criteria. We suggest that an example be included in the implementation guidance illustrating how an implied contract could meet each of these criteria.

Furthermore, we also note that there is no specific requirement for persuasive evidence of an arrangement to exist prior to revenue being recognized as required in current U.S. GAAP in ASC 605-10 and ASC 985-605. While many of the criteria in paragraph 10 are indicative of

persuasive evidence of an arrangement, we believe this concept should be explicitly included in the ASU noting that a company's customary form of evidence would be considered persuasive evidence of an arrangement.

Transaction price

1. In light of the guidance in paragraph 43 regarding changes in the assessment of credit risk being recognized in income or expense rather than as revenue once a receivable has been recorded (as we commented on in response to Question 5), it is unclear to us how this paragraph along with paragraph 41 should be interpreted in regard to certain changes in the assessment of credit risk. The relevant portions of paragraph 41 state, "If the transaction price cannot be reasonably estimated, an entity shall not recognize revenue from satisfying a performance obligation. If circumstances change, the entity shall recognize revenue from satisfied performance obligations when the transaction price can be reasonably estimated." As an example of how this guidance and other guidance in the proposed ASU could be interpreted in two different manners, consider a contract in which the transaction price couldn't be reasonably estimated prior to the transfer of control of the good solely due to collectibility concerns. Assume that this contract was for the sale of a product to a customer for \$100. Control of the product was transferred to the customer on September 15, 2010 but the transaction price couldn't be reasonably estimated at that date due to collectibility concerns. Based on paragraph 41, we would expect that if the entity actually collects the \$100 due subsequently that it should be classified as revenue. This view would be further supported by the notion that there is actually no receivable in this case prior to collection (rather than a receivable of \$0) and therefore any amounts subsequently collected would be classified as revenue. This view that there is no receivable prior to collection would be consistent with current U.S. GAAP practice when transferring rights to amounts due from customers to third parties for which revenue has not yet been recognized. Based on a speech by Joseph McGrath, Professional Accounting Fellow in the SEC's Office of the Chief Accountant, at the 2006 AICPA National Conference on Current SEC and PCAOB Developments, those transfers are not considered transfers of financial assets under ASC 860-20, *Sales of Financial Assets*, as there is no financial asset or receivable recorded until the related revenue is recognized. In further support of this view, paragraph IG79 implies that if a transaction price cannot be reasonably estimated due to collectibility at inception of a contract, it would be recorded as revenue when the amount could be reasonably estimated at a later date or when cash is collected.

However, an alternate view based on paragraph 43 would be that since the entity had an unconditional right to receive the invoiced amount of \$100 (receivable) after transferring control of the product, any future changes in assessment of credit risk would be classified within income or expense. Therefore, in the preceding example, \$100 cash would be classified as income when collected. This would also be consistent with an interpretation of paragraph 41 that a change in the assessment of credit risk is not actually a change in transaction price. In any event, we suggest that the Boards clarify the appropriate interpretation in this type of scenario as well as clarify whether a change in the assessment of collectibility once a receivable is recorded is considered a change in transaction price.

2. We believe that the term "transaction price" is a bit misleading. Typically the common usage of the term "price" is the amount at which something is bought or sold for, such as an invoice price. Transaction price as discussed in the proposed ASU requires contemplation of factors other than an invoice price such as variable consideration, collectibility, time value of money and noncash consideration. We believe that a more descriptive term than "transaction price" should be used such as "transaction consideration" or "transaction value."
3. The determination of transaction price is discussed in paragraphs 35-49. In paragraph 38, the first sentence proposes that "An entity shall recognize revenue from satisfying a performance obligation only if transaction price can be reasonably estimated." As these paragraphs are strictly

focused on estimating the transaction price, it is unclear why there is a reference to the timing of revenue recognition. We'd suggest that there should be no reference to recognizing revenue in this section of the proposed ASU as it could cause confusion between the measurement of the transaction price and the timing of recognition. We'd propose the sentence be altered to state "Amounts can only be included in the transaction price if they can be reasonably estimated." We have similar comments on paragraphs 41 and 49 and would recommend similar modifications.

Rights of return

1. The example on product returns included in the implementation guidance (Example 3) is relatively straightforward. We believe there are many other situations in which the accounting for product returns is unclear based on the proposed guidance and that it would be helpful to include additional implementation guidance. For example, we believe it would be beneficial to include an example of a contract in which there are multiple products with different estimated selling prices and the refund amount a customer is entitled to for each product differs from the allocated transaction price. One of the areas in which the accounting could be unclear in this scenario would be in regard to the amount that should be recorded for the refund liability for the unfulfilled performance obligations. Example 3 would suggest that the refund liability for the unfulfilled performance obligations should be based on the transaction price multiplied by the number of products expected to be returned. However, an argument could be made that the refund liability should be based on the amount to be refunded for each product returned multiplied by the number of products expected to be returned.
2. We did not note any discussion of the appropriate accounting treatment for refundable service fees in the proposed ASU. The existing U.S. GAAP guidance is currently included in ASC 605-10-S99 (SAB Topic 13.A.4.a) and allows in certain cases for an analogy to be made to the current U.S. GAAP guidance on product returns (ASC 605-15-25). It is unclear to us whether the proposed ASU allows for refundable service fees to be accounted for in a manner similar to that for product returns or whether refundable service fees should be evaluated as consideration payable to a customer when determining the transaction price. We believe that this is a common practice issue that should be addressed in the proposed ASU. We suggest that guidance be included in the proposed ASU directly addressing this issue including the principle to follow as well as related illustrative examples.
3. In paragraph 37, a refund liability is required to be recognized if an entity receives consideration from a customer and expects to refund some or all of that consideration. Furthermore, in paragraph IG7 it is stated that a customer returning a product may receive a refund, a credit for other goods or services or another product in exchange. Our presumption is that in any of these scenarios (except if there is an exchange for another product of the same type, quality, condition and price), an entity must estimate a refund liability. If this presumption is correct, it would seem that the term "refund liability" is misleading since several of these cases will not require refunds. Therefore, we suggest that a more inclusive term be used to describe this liability, such as product return liability.

Noncash consideration

The proposed ASU states in paragraph 46 that an entity shall measure noncash consideration at fair value and if it is not reasonably estimable, the consideration shall be measured indirectly by reference to the standalone selling price of the goods or services transferred in exchange. We believe this guidance for measuring noncash consideration indirectly is appropriate in situations in which noncash consideration is the only consideration being received in a contract for a single performance obligation. However, in contracts in which a combination of cash and noncash consideration is included and there is more than one performance obligation, we believe the results of applying this guidance may not match the economics of a transaction. The reason for this is the overall transaction

price in these situations would always equal the standalone selling prices of each of the performance obligations without any discount. We believe in many cases this would overstate the transaction price as typically when performance obligations are sold as a package with other performance obligations the total price is discounted from the price when sold on a standalone basis.

For example, assume an entity sold products A and B in a contract for \$100 cash and the standalone selling price of each of these products was \$70. The transaction price allocated to each of these products would be \$50 using a relative standalone selling price method. Now assume the facts were altered such that products A, B and C are sold in a contract for \$100 plus noncash consideration (whose fair value is not reasonably estimable) and the standalone selling price of each of these products was \$70. Since the fair value of the noncash consideration is not reasonably estimable, the consideration must be measured indirectly based on the standalone selling price of the goods or services transferred in exchange. Based on the proposed ASU, we believe the resulting accounting treatment is unclear. One view is that the entity should aggregate the standalone selling price of all three products and the transaction price would be \$210, which is ultimately recognized as revenue. The other view is that the entity determines that the \$100 cash was paid for products A and B so it only has to utilize the standalone selling price of product C to measure the noncash consideration. Under this view, the transaction price is determined to be \$170 (\$100 cash + \$70 standalone selling price of product C), which is ultimately recognized as revenue. We believe the economics of this transaction are such that the maximum transaction price should be \$150. This is based on \$100 cash paid when products A and B are sold together plus an additional \$50 for product C (since it has the same standalone selling price as products A and B), assuming there is no volume discount for adding this third product. However under both views noted previously, the transaction price is higher. We recommend that this principle in the proposed ASU be modified after taking these examples into account such that the application of the guidance would result in a transaction price of no greater than \$150.

Consideration payable to a customer

In Example 23 of the implementation guidance, there is an illustration of the treatment of consideration payable to a customer (a reseller) for slotting fees. In this example, the product placement service performed by the customer to earn the slotting fee is considered distinct because it has a distinct function and a distinct profit margin. There is no further discussion in the example as to how this determination is made.

It is unclear how slotting fees paid for a product placement service could ever be considered distinct. A service is considered distinct in accordance with paragraph 23 if the entity or another entity sells an identical or similar good or service separately, which couldn't be the case with a product placement service as the service could only be sold by a reseller to an entity that is selling products to them. Alternatively, a service is distinct if *the entity could sell the service separately* because the service has (a) a distinct function and (b) a distinct profit margin. As noted earlier, a product placement service inherently could not be sold separately. Therefore, if it is possible, as noted in this example, for product placement fees to have a distinct function and distinct profit margin, then we think those two criteria are not sufficient for purposes of determining whether an entity could sell the service separately. In other words, there may need to be a third criterion added that would disqualify product placement fees as an item that an entity could sell separately. Alternatively, if the product placement service really does not have both a distinct function and profit margin, we believe the example needs to be modified.

Customer options for additional goods or services

In paragraph IG25, it is noted that if an entity grants an option to a customer to acquire additional goods or services that promise gives rise to a separate performance obligation in the contract only if the option provides a material right to the customer that they would not receive without entering into

that contract. An example of a material right noted is a discount on future goods or services that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographic area or market. We believe that further implementation guidance is necessary regarding the evaluation of a “material right”. For example, the proposed guidance seems relatively consistent with that included in current U.S. GAAP (ASC 985-605-15-3-d) for software transaction when evaluating whether optional items should be considered elements within arrangements. In practice, application of the current U.S. GAAP guidance generally results in optional postcontract customer support (PCS) not being considered an element within a software arrangement. It is unclear to us as to whether the application of the guidance in the proposed ASU will be consistent with current U.S. GAAP in these situations in regard to whether the optional PCS will be considered a material right and believe additional guidance should be included to address this issue.

This lack of clarity is also due to the discussion in paragraph IG88 of the practical alternative to directly estimating the standalone selling price of an option that provides a material right for situations in which the optional goods or services are similar to the original goods or services in the contract and provided in accordance with the terms of the original contract. This alternative allows for entities to allocate the transaction price to the optional goods or services based on their estimated standalone selling prices, expected renewals and expected consideration. An illustrative example on this guidance is included as Example 27, in which the standalone selling prices of maintenance each year are considered to increase based on an expectation that additional costs will be incurred. It is unclear to us how this example will impact entities that include PCS renewals in contracts as noted previously. In many cases, the renewal rate for PCS is considered objective and reliable evidence of fair value in current U.S. GAAP and the issue is whether that evidence will be allowed to be considered when determining the estimated standalone selling price of the support as well as whether the optional PCS is considered a material right. We suggest an additional example be added in this section to address PCS and clarify this issue.

Nonrefundable upfront fees

In paragraph IG28, nonrefundable upfront fees are recognized as revenue when the promised future goods or services are provided. It is further stated that the revenue recognition period would extend beyond the initial contract period if the customer is given a material right to renew the contract. In the subsequent example, both scenarios include renewal options and the conclusion is that the upfront fee should be recognized “as revenue during the period that the entity expects to provide services to the customer.” It is unclear whether the period over which the entity expects to provide services to the customer is the period of recognition only due to the fact that there are renewal options that must be considered. In other words, we believe that the guidance should be clarified to include an additional example with no stated renewal option and note the period over which the revenue would be recognized. We believe in this scenario that the period over which revenue would be recognized would either be simply the contractual period or an expected period over which services will be provided based on customers’ history of continuing as customers subsequent to the initial contract term even without a stated renewal option. The latter accounting treatment would be consistent with existing U.S. GAAP.

Onerous performance obligations

In paragraph 56, it is proposed that that an entity shall update the measurement of the liability for an onerous performance obligation at each subsequent reporting date. However, the proposed ASU does not appear to explicitly state when the assessment of onerous performance obligations must initially be determined. We assume this assessment must be performed at inception of the contract and at the end of each reporting period, but suggest that the timing of this assessment is included in the final guidance.

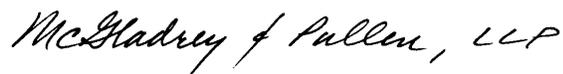
Disclosure

We believe that certain of the disclosure requirements proposed are excessive and should not be required. For example, a rollforward of contract assets and liabilities is required by paragraph 75, which identifies specific detailed items that must be included such as cash received, contracts acquired in business combination and disposed among others. While we are not a financial statement preparer, we understand that gathering this type of information for disclosure purposes will be onerous for preparers and require significant costs to be incurred to reconfigure accounting systems. We also question whether this information will be useful for investors if preparers themselves do not use it internally to manage their business.

If the rollforward disclosure requirement is retained in the final guidance, we believe that the disclosure of cash received in paragraph 75(b) should only be included as part of the rollforward if the Financial Statement Presentation project requires such amounts to be disclosed in the revised statement of cash flows. Furthermore, we believe further clarification is needed regarding what is meant by the term “contracts disposed” in paragraph 75(e).

We would be pleased to respond to any questions the Boards or their staff may have about any of the preceding comments. Please direct any questions to either Jay D. Hanson (952-921-7785) or Brian H. Marshall (203-312-9329).

Sincerely,

A handwritten signature in cursive script that reads "McGladrey & Pullen, LLP".

McGladrey & Pullen, LLP