July 27, 2009

Technical Director – File Reference No.1660-100
Financial Accounting Standards Board
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The Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) appreciates the opportunity to comment on the joint FASB/IASB Discussion Paper, *Preliminary Views on Revenue Recognition in Contracts with Customers*.

AcSEC appreciates the Boards' efforts to develop a single revenue recognition model, and believes it would be an improvement to financial reporting to have a single model for all contracts. AcSEC believes the model proposed in the Discussion Paper is a good starting point, yet recognizes that there are a number of critical areas not yet addressed by the Boards including, for example, measurement of contract rights. We have specific concerns for the Boards to address in their continued discussion of this project, as discussed in Appendix A.

The Discussion Paper embodies pervasive legal determinations. A significant overall concern of AcSEC is whether application of a final standard will require assistance from the legal profession to interpret many common business agreements that do not pose accounting issues today. If such significant legal evaluations are not the Boards' intent, we urge the Boards provide additional clarity on the subject. Some specific concerns include:

- The proposed definition of a contract is unduly focused on the enforceability of legal obligations, and we recommend that the Boards revise the definition to make it clear that it is an agreement between two or more parties that creates an explicit or implicit duty to perform.
- The discussion paper appears to indicate that the transfer of control is grounded in a legalistic view which may not always reflect the substance of the transaction. We recommend that the Boards provide a clear principle of when control transfers and provide a list of indicators that could be used in determining if control has been transferred.
- Because legal interpretations of complex arrangements will often be necessary, this may in some circumstances produce unclear or inconclusive results as well as changes in conclusions. We urge the Boards provide guidance regarding appropriate accounting and disclosures in such circumstances.

AcSEC also has the following concerns on the Discussion Paper:

- We believe that the Boards should provide guidance as part of any final standard on when changes to an existing contract (e.g., change orders, options, and renewals) should be considered for purposes of revenue recognition.
- We request additional guidance for determining what components of a contract should be considered performance obligations, specifically for transactions that include price adjustments, returns, service level guarantees, discretionary performance obligations, contract features that can be unilaterally changed, and contingent optional deliverables.

- We believe the accounting for return rights should be based on a modified failed sale approach, as discussed further in the responses in Appendix A, as that most accurately reflects the economics of the transaction.
- We request that the Boards provide clarifying guidance for sales incentives, specifically whether the general availability of similar sales incentives impact the stand-alone selling price of such performance obligations when the incentives are provided in conjunction with a current contract.
- We do not support the inclusion of an onerous test in the proposed model. We believe that onerous contracts should be evaluated within existing liability standards.
- We recommend the Boards amend existing asset standards to provide guidance regarding appropriate accounting and disclosures for certain contract related costs.
- We believe that there are circumstances (e.g., unique items that have never been sold separately by the entity) where estimating a stand-alone selling price may prove challenging, and encourage the Boards to consider additional guidance for such situations.

A complete response to the Boards' specific questions is included in Appendix A.

Representatives of AcSEC are available to discuss our comments with the Boards' members and staff.

Yours truly,

Jay D. Hanson

Jay D. Hanson, Chair
Accounting Standards Executive Committee

Glenn Bradley, Chair
Revenue Recognition Task Force

Appendix A

Response to Questions:

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

AcSEC agrees with the Boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability. Using an asset and liability model for the recognition of revenue (as opposed to the current earnings or activities-based model) is consistent with the existing US GAAP and IFRS frameworks' balance sheet based approach.

In addition, we believe that having a single model, without the need for industry specific exceptions, will improve consistency in revenue recognition for economically similar transactions.

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

AcSEC believes that providing a model that can be applied across industries to achieve consistent answers to economically similar transactions is important. To achieve this, we believe the Boards should generally not scope out any contracts from the proposed revenue recognition model. However, we appreciate the practical challenges such an effort presents. In that respect, we considered whether the contracts specifically mentioned by the Boards should be excluded from the scope of this standard.

- Financial instruments and some nonfinancial instrument contracts that otherwise would be in the scope of existing financial instrument guidance
    - In the proposed model, revenue is recognized when an entity satisfies a performance obligation in a contract through the delivery of a good or performance of a service. Financial instrument contracts do not involve either the delivery of a good or performance of a service, rather constitute an agreement to exchange cash. Accordingly, we do not believe these contracts should be within the scope of this proposed model.

- Insurance contracts
    - We acknowledge that the Boards have an on-going project relating to insurance contracts. Accordingly, we believe that as a practical expedient, the accounting for insurance contracts should continue to be addressed by the Boards' project on insurance accounting. However, the Boards should ensure that, where appropriate, the principles of revenue recognition for insurance contracts are broadly consistent with the principles in this proposed model. This will help to achieve the Boards' goal of ensuring economically similar transactions receive consistent accounting treatment, regardless of industries.

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- Leasing contracts
  - We acknowledge that the Boards have an on-going project relating to leases. Accordingly, we believe as a practical expedient, that the accounting for lessor revenue recognition should continue to be addressed by the Boards' project on leases. However, as with insurance contracts, the Boards should ensure that the principles of revenue recognition for lessors are broadly consistent with the principles in this proposed model, particularly as the principles in this model relate to the revenue recognition for the transfer of a right to use an intangible asset (e.g., a software license).

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

AcSEC believes that a contract is an agreement between two parties that determines the rights and obligations of each party. We are concerned that the proposed definition is unduly focused on the enforceability of legal obligations, and that some may interpret the reference therein to "enforceable obligations" as the ability to compel performance by legal means, if necessary. We do not believe that it is the Boards' intention to require a legal interpretation for every contract. We recommend that the Boards revise the definition to make it clear that it is an agreement between parties that gives rise to rights and obligations, which would include past business practices. In that regard, we recommend the following revised definition: A contract is an agreement between two or more parties that creates an implicit or explicit duty to perform.

We believe that the Boards should provide guidance in any final standard on when changes to an existing contract (e.g., change orders, options, and renewals) should be considered for purposes of revenue recognition. Further, we believe it is critical for the Boards to provide a principle for when separate contracts should be combined. Such a principle should ensure that separate contracts be combined if necessary to accurately portray the underlying economics of the transaction. Finally, we acknowledge that the Boards have provided a principle on when assets within a contract should be segmented (i.e., separation should occur when assets transfer to the customer at different times). However, this principle should be clarified to ensure that contract terms are not separated for purposes of revenue recognition, if such separation does not reflect the substance of the arrangement.

We also believe the Boards should address how contracts (and contract terms) that lack commercial substance (as discussed in FASB Statement No. 153, *Exchanges in Nonmonetary Assets*) should be accounted for under the proposed model.

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

AcSEC believes the proposed definition of a performance obligation provides a good starting point for determining what components of a contract should be considered performance obligations for purposes of revenue recognition. However, we believe that the following additional guidance is needed on the following items:

- The proposed model suggests that obligations, whether enforceable explicitly through contract terms or implicitly though statutory law, are performance obligations. However, the Boards also suggest that obligations created constructively through past business practices may also be performance obligations. We believe the Boards need to reconcile the concept of legal enforceability with that of a constructive obligation that may or may not be legally enforceable.
- Discretionary performance obligations and contract features that can be unilaterally changed during the contract by the company. For example, discretionary warranties or non-contractual return policies.
- Price protection or price matching: If another company, or the entity itself, sells the same product in the future at a lower price and the entity offers to refund the difference, would that represent a performance obligation or an adjustment to the measurement of the contract right?
- Optional deliverables that are contingent on future performance by the company or action by the customer. For example, "when-and-if-available" upgrades.
- Exchange rights: If an entity offers the customer the ability to exchange one product for another similar product, would that represent a performance obligation? Would this determination change if the exchange was for a different product (e.g., exchange a TV for a DVD player)?
- Product liability guarantees: If an entity either explicitly or implicitly guarantees that a product will not cause harm, does that represent a performance obligation?
- Service level guarantees: If an entity explicitly guarantees that a product will be usable a certain percentage of the time, does that represent a performance obligation?
- Service contracts: The Boards should provide enhanced guidance on how payment terms (non-refundable or otherwise) impact the determination of a performance obligation in a service contract. For example, if an environmental consultant receives non-refundable payments over the term of the contract, does that indicate that the performance obligation is to render services on a 'best efforts' basis? Would the answer change if the consultant's fee was contingent upon timely delivery of the environmental report? Another example would be if a real estate agent was hired to sell a customer's house. Would the determination of the performance obligations differ if the agent's fee was based on an hourly rate for services as compared to a fee that was solely contingent upon selling the house?

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?

AcSEC agrees that an entity should separate performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer. However, as noted in our response to question 3, this principle should be clarified to ensure that contract terms are not separated for purposes of revenue recognition, if such separation does not reflect the substance of the arrangement. For example, in the discussion paper the Boards provide an example of a construction contract whereby each service hour, brick and nail may represent separate performance obligations. We believe that separating obligations at such a disaggregated level may not represent decision-useful information nor represent the substance of the arrangement.

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Current presentation and disclosure requirements may also require separation of elements if, for example, a contract provides for concurrent transfer of goods across multiple reportable segments, or concurrent delivery of goods and services. Further, if a contract provides for the concurrent transfer of more than one good at a time and the transfer of other goods at a different time, separation may be required to ensure appropriate allocation of contract consideration using a relative selling price approach.

AcSEC agrees with the proposed rebuttable presumption that an asset used in satisfying another performance obligation is not transferred to the customer until the asset is used in satisfying that performance obligation. However, we believe that application of this presumption could present challenges especially with interdependent deliverables.

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?

AcSEC agrees that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation. However, because the proposed model is based on the transaction price, we believe that accounting for return rights based on a modified failed sale approach most accurately reflects the economics of the transaction.

The Discussion Paper presents alternative models on accounting for return rights; as a performance obligation or as a failed sale. We believe that, individually, both models present challenges in application. For example, if a return right is accounted for solely using a failed sale model, inventory would continue to be recognized despite control of those goods being transferred to the customer. We believe this would create an unnecessary exception to the control transfer principle proposed by the Boards.

Using a modified failed sale model, however, provides for an accounting result that is in line with the revenue recognition principle proposed by the Boards. We would, therefore, offer the following recommendation:

When an entity enters into a contract with a customer for the sale of goods, it would estimate the expected goods to be returned (i.e., failed sale) and defer revenue recognition until such return right expires. If cash is received for such goods, a liability should be recognized by the entity for the amount of cash expected to be refunded. We believe this is appropriate under the proposed model as the entity's contract asset (and therefore contract liability) is the transaction price, less the amount of consideration expected to be refunded upon return of the goods. An entity should update this estimate using all relevant available information at each reporting period.

For those goods that are not expected to be returned, an entity has at least two performance obligations for which consideration should be allocated; an obligation to sell the goods and an obligation to provide a service, that of standing ready to accept the returned goods and refund the customer's consideration. We acknowledge that estimating the stand alone selling price of such stand-ready obligation will present practical challenges and, in many instances, may not be material. We encourage the Boards to provide guidance on how such a return right might be measured in a way that appropriately reflects the economics of the transaction.

When control of the goods transfers to the customer, an entity would recognize revenue in an amount equal to the transaction price allocated to those goods (less the amount of consideration expected to be refunded for sales expected to fail) and derecognize the full cost of those goods. We believe that derecognizing the full cost of the goods controlled by the customer is required under the proposed model.

For a material stand-ready obligation to accept the returned goods and refund consideration (for those goods not expecting to be returned), an entity would recognize revenue equal to the allocated transaction price over the expected return period using a systematic and rational method. An entity would adjust its recognition based on actual return experience.

Inherent in a contract containing a customer's right to return goods and receive consideration is an entity's reciprocal right to receive the value of those goods in return. We believe this executory right constitutes a contract asset. Such asset should be initially measured at the original cost of the goods expected to be returned, not to exceed the net realizable value, with a corresponding adjustment to cost of sales.

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?

AcSEC agrees that sales incentives, other than cash rebates, give rise to performance obligations if they are specified within the terms of the current transaction. However, we request that the Boards provide measurement guidance for sales incentives. Specifically, the Boards should consider whether the general availability of similar sales incentives impact the stand alone selling price of such performance obligations when the incentives are provided in conjunction with a current contract. In addition, the Boards' should consider how forfeitures of available sales incentives impact the estimation of the stand-alone selling price of performance obligations identified in a contract.

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.

AcSEC believes that a single trigger, based on control, will increase consistency in revenue recognition for economically similar transactions, irrespective of industries. However, we are concerned that the discussion paper appears to indicate that the transfer of control is grounded in a legalistic view tied to the transfer of title which may not always reflect the substance of the transaction. For example, we believe that in many situations, such as when services are provided or when licenses to intellectual capital are obtained, transfer of legal title will not always exist. Therefore, we encourage the Boards to provide a clear principle of when control transfers. This principle should not be grounded in a legalistic view point but rather one that ensures revenue is recognized based on the economic substance of transactions.

AcSEC also recommends that the Boards provide a list of indicators that could be used in determining if control has been transferred, as well as provide more complex examples than are currently included in the discussion paper. These indicators should address when control transfers at a point in time and when control transfers continuously over the term of the contract (e.g., situations common to long-duration contracts). As noted in our response to Question 4, additional guidance is needed in defining performance obligations which also plays into the determination of when control is transferred.

We acknowledge that the discussion paper does not address the measurement of revenue when control of an asset (whether a good or service) continuously transfers. We do, however, believe that addressing this within the context of the revenue standard is important. In situations where an entity determines that control of an asset continuously transfers, we believe existing US GAAP and IFRS guidance provides well-understood and conceptually sound output (e.g., surveys of work performed) and input methods (e.g., the proportion that contract costs incurred for work performed to date bear to total estimated contract costs). Entities should be afforded the flexibility to select a method that provides the best proxy for the transfer of control. However, we believe the Boards should specify that if an entity elects to employ a cost-to-cost input method to estimate the amount of goods and services that have been transferred, the entity must be able to demonstrate that the relationship is a representative pattern of the amount of goods and services that the customer has received.

AcSEC is also concerned the example in paragraph 4.27 of the discussion paper, regarding accounting for linked assets, could result in entities manipulating contract terms to schedule delivery at separate times even if all assets need to be used together. It does not appear to be appropriate to change the accounting result by contractually structuring the delivery and control transfer of separate pieces of linked assets.

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.

AcSEC agrees that, for those contracts within the scope of this project, revenue should only be recognized when a properly identified performance obligation is satisfied.

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10 In the Boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

a. Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

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

c. Do you think 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 characteristics of the obligations make that approach unsuitable? Please provide examples.

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

a) AcSEC agrees that performance obligations should be measured initially at the transaction price, as the transaction price provides a reasonable measure of the goods and services to be provided under the contract and avoids the cost and complexity of an entity searching for another price (e.g., exit price).

b) AcSEC does not support the inclusion of an onerous test in the proposed model. We believe that onerous contracts should be evaluated in accordance with other existing liability standards.

Further, we believe that estimated losses on onerous contracts may effectively represent an accrual of future operating costs, as a liability for such costs may not exist at the time one is recorded. Also, it is unclear how the recognition of an onerous contract loss reconciles to the Boards' decisions in the conceptual framework project. It appears that a primary justification for including an onerous remeasurement test is conservatism, but the conceptual framework project notes that neutrality is essential to the faithful representation of underlying economic phenomena and that conservatism is inconsistent with the notion of neutrality.

While we do not believe onerous contracts should be addressed in a revenue standard, we encourage the Boards to consider whether a loss on an onerous contract should be recognized when known, or when realized. In either case, we believe that the Boards need to provide clear disclosure requirements around onerous contracts (e.g., explaining the nature of the contract, reason for the loss, expected range of loss, and any changes in estimates from the prior period).

If the Boards continue to include an onerous test in this project, AcSEC prefers the cost test over the current price test.

c,d) AcSEC believes that, subject to the contracts discussed in Question 2, there are no performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date.

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11 The Boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (for example, selling costs) are included in the initial measurement of the performance obligations. The Boards propose that an entity should recognize those costs as expenses unless they qualify for recognition as an asset in accordance with other standards.

a. Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligation? Why or why not?

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.

a,b) AcSEC agrees that the 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 obligation. Further, we agree that the accounting guidance for contract-related costs should not be included in the revenue standard. However, we believe that the Boards should amend existing asset standards to ensure that certain contract related costs are properly accounted for as assets.

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?

AcSEC agrees that the transaction price should be allocated to the performance obligations on the basis of the entity's relative stand-alone selling prices as this provides for an economically sound allocation of the transaction price. We acknowledge the Boards' view that entities should be able to estimate stand-alone selling prices when such prices are not readily available. However, there are circumstances (e.g., unique items that have never been sold separately by the entity) where estimating a stand-alone selling price may prove challenging. We encourage the Boards to consider additional guidance for such situations.

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?

AcSEC agrees that if an entity does not sell a good or service separately it should estimate the stand-alone selling price of the good or service for purposes of allocating the transaction price. However, as noted in our response to Question 12, we believe such estimations may be difficult in certain circumstances and encourage the Boards to consider additional guidance for such situations.

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Other Items:

We recognize that the discussion paper does not address certain topics that are expected to be addressed by the Boards as the exposure draft of a final standard is further developed. We have taken this opportunity to provide comments and suggestions to the Boards on measurement of contract rights (specifically contingent consideration) as this is critical to understanding, and applying, the proposed model as a whole.

Our comments below are based on the tentative conclusions reached by the Boards to-date. Specifically, we understand that the following tentative conclusions around contingent consideration have been reached:

1. The Boards decided that when the customer consideration is uncertain (variable) in amount, the transaction price at inception is the amount of the expected customer consideration, defined as the probability-weighted estimate of customer consideration.
2. An entity would update the measurement of rights to reflect changes in the transaction price and allocate those changes to the recognized performance obligations. The effects of those changes on satisfied performance obligations would be recognized as revenue in the period of change.
3. Revenue should not be constrained unless consideration is “impracticable to reliably measure.”

We appreciate that the Boards may modify or clarify these tentative conclusions in future board meetings. Accordingly, our comments below are based only on the tentative conclusions reached to date.

We acknowledge that the transaction price may be uncertain as a result of contingencies inherent in the contract with the customer. However, to ensure that the accounting reflects the expected economics of the transaction, we believe that such contingencies should be considered in determining a probability-weighted estimate of the transaction price.

We do not believe that such estimates should be constrained to situations where it is “impracticable to reliably measure.” Such a threshold provides for an unnecessary exception to the proposed model and will create inconsistencies in deriving estimates and inconsistencies in determining when to apply this exception.

While, under US GAAP, there are many situations where the recognition of contingent consideration is not permitted, there are also situations, across several industries, where an established practice of estimating, and recognizing, contingencies is well-understood. This includes, for example, the construction and defense industries.

While we believe that recognizing revenue when performance obligations are satisfied, even if amounts are uncertain, represents a better reflection of the economics, we also note that there are many other areas of both US GAAP and IFRS where recognition thresholds exist (e.g., gain and loss contingencies) or where contingencies are accounted for at fair value (e.g., contingent consideration in business combinations). We encourage the Boards to ensure that the recognition of contingent revenue in this proposed model is consistent with (or at least reconciled to) the principles for the recognition of contingencies in other areas.

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Finally, because of the sensitive nature of such estimates in many instances, we encourage the Boards to consider the extent of disclosures needed. Such disclosures might include the nature of the contingency, potential range of outcomes, contingent amounts recognized and unrecognized, and the effect of any adjustments to estimates made in the prior period.