

Private Company Financial Reporting Committee

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Judith H. O'Dell CPA CVA
Chair

February 10, 2012

Ms. Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT06856

Re: Proposed Accounting Standards Update, *Revenue from Contracts with Customers* (“Proposed ASU”)

Dear Ms. Seidman:

The PCFRC has reviewed the Proposed ASU and has, as you know, discussed its proposed revenue recognition requirements with the FASB and FASB staff during recent PCFRC meetings. Overall, the Committee is pleased with the revisions made to the original Proposed ASU, particularly those affecting the construction industry. The PCFRC offers the following recommendations and comments.

Enforceability of contracts/performance obligations

The guidance in paragraphs 13 and 24 of the Proposed ASU may lead to confusion in implementing the final standard. Paragraph 13 states:

“A contract is an agreement between two or more parties that creates enforceable rights and obligations...An entity shall consider...practices and processes in determining when an agreement with a customer creates enforceable rights and obligations of the entity.”

Paragraph 24 states:

“Performance obligations include promises that are implied by an entity’s customary business practices, published policies, or specific statements if those promises create a valid expectation of the customer that the entity will transfer a good or service.”

It appears that the guidance in paragraph 13 emphasizes the enforceability of a contract while paragraph 24 emphasizes an entity's customary business practices. Some may see conflict between those two paragraphs. The PCFRC is unsure about what the FASB intended. The distinction between what is a "contract" and what is a "performance obligation" could be murky and subject to potential abuse. Since a contract is required to be "enforceable" and a performance obligation is not, some may attempt to classify items as contracts. Accordingly, the PCFRC recommends that the FASB clarify this guidance.

Input Methods - Accounting for wasted materials

Paragraph 45 of the Proposed ASU requires that an entity exclude the costs of wasted materials when using an input method. Also, paragraph 93 of the Proposed ASU requires entities to expense wasted materials as incurred. In the construction industry, wasted materials are not considered as a separate item but rather are assessed regularly and are an adjustment of job cost. Therefore, the cost of wasted materials is not considered as overhead but remains as part of the job cost, forcing a lower gross margin. The PCFRC is concerned about uncertainty in understanding and implementing the guidance on accounting for wasted materials in the Proposed ASU. As such, the Committee recommends that the FASB clarify this guidance. In particular, a definition of "wasted materials" is needed and a clearer explanation of the accounting for normal, expected wasted materials versus the accounting for abnormal wasted materials is also needed.

Input Methods – Accounting for goods that the customer obtains control of significantly before receiving services related to those goods

Similar to the preceding issue, the PCFRC is concerned about diversity in implementing the guidance in paragraph 46 of the Proposed ASU. Specifically, the PCFRC is concerned with the proposed accounting for materials delivered to a construction job but not yet installed. The Committee understands that the FASB tried to strike a compromise by allowing revenue to be recognized to the extent of cost, but not gross margin because no value has been added to the materials delivered. Some members of the PCFRC believe that gross margin should be recognized when the materials are delivered if the customer has accepted the cost and title and is being billed for those materials. This is common industry practice. Others on the PCFRC do not believe that full profit margin should be recognized if no installation has been performed. The Committee is concerned that some will interpret the Proposed ASU in a manner that assigns zero profit margin to the delivered materials and all profit margin to installation while others will assign some level of profit margin to the delivered materials. As such,

the PCFRC recommends that the related guidance be reconsidered and either clarified or removed.

Disaggregation of Revenues by Nonpublic Entities

Paragraph 116 of the Proposed ASU states:

“A nonpublic entity shall disaggregate revenue in accordance with the timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time).”

The PCFRC is of the opinion that nonpublic entities should disaggregate revenue in a manner that is the most useful to the users of their financial statements. The Committee believes that is the FASB’s intent regarding the disaggregation of revenues as described in paragraph 114 of the Proposed ASU. As such paragraph 116 should be revised to reflect that intent and allow nonpublic entities the flexibility to disaggregate revenues in a way that provides the most useful information to their financial statement users.

Take-or-Pay Contracts

The PCFRC is uncertain about the accounting for take-or-pay contracts (an agreement between an entity and its customer in which the customer will still pay a specified minimum amount even if the product or service is not provided by the entity) under the Proposed ASU and recommends that the FASB consider providing guidance about these contracts. Take or pay contracts are very common in the energy and commodities industries. Guidance or an example about identifying performance obligations, determining and allocating the transaction price, and recognizing revenue on performance obligations under take-or-pay contracts would help avert uncertainty and diversity in applying the Proposed ASU to these contracts.

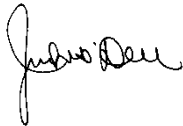
Transition

The PCFRC believes that nonpublic entities should not be required to retrospectively apply the Proposed ASU. Rather, a less costly alternative method, such as disclosure in the notes to the financial statements, should be considered and developed by the FASB. On the one hand, financial statement users prefer two years of comparative financial data and consistency of presentation is an important aspect of financial reporting. On the other hand, nonpublic entities will incur significant cost and expend significant time in applying the Proposed ASU retrospectively. To be sure, this cost will likely drive many nonpublic entities to provide their financial statement users with only

single-period financial statements and thus avoid the retrospective application. Single-period financial statements will deprive financial statement users of comparability and be less beneficial to them. Further, users are likely to be confused and frustrated with the varied application of the Proposed ASU to prior periods. Some nonpublic entities will retrospectively apply the Proposed ASU and others will not. User models and trend analysis will be on two different sets of GAAP. To bridge these competing realities, the PCFRC recommends that requiring disclosure of the retroactive impact of the Proposed ASU instead of retrospective presentation may be the better alternative. Disclosure would help reduce implementation costs and also provide the financial statement users with comparative financial data.

The PCFRC appreciates the FASB's consideration of these recommendations and comments. Please feel free to contact me if you have any questions or comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Judith H. O'Dell". The signature is fluid and cursive, with a large initial "J" and "O".

Judith H. O'Dell
Chair
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