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March 22, 2012

VIA EMAIL TO: director@FASB.org

Technical Director
File Reference No. 2011-230
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, *Revenue from Contracts with Customers*

To Whom It May Concern:

Our firm, Financial Reporting Advisors, LLC, provides accounting and SEC reporting advisory services, litigation support services, and dispute resolution services. We specialize in applying generally accepted accounting principles to complex business transactions. We are writing to provide comments on the FASB's Proposed Accounting Standards Update, Revenue Recognition (Topic 605): *Revenue from Contracts with Customers* (the ED).

We commend the FASB for its work to date on this project. We believe the accounting literature on revenue recognition requires improvement, as it currently suffers from a number of inconsistencies and, despite fairly extensive industry guidance, omissions. We believe that correcting these deficiencies through the publication of a comprehensive standard on revenue recognition will be an improvement to the US generally accepted accounting principles (GAAP).

We believe that the model proposed in the ED would address many of the deficiencies in the current revenue recognition literature. We are encouraged that the guidance in the ED has the potential to increase consistency across reporting companies, provide principle-based guidance to address issues that are not currently addressed, and improve the relevance of reported information about revenues, while reducing the volume of revenue recognition literature. We also believe that the changes made between the 2010 ED on this topic and the current ED have improved the operability of the proposed guidance.

The ED notes that the FASB and the International Accounting Standards Board (collectively, the Boards) are not seeking specific comments on all matters, but are instead seeking comments on "...whether the proposed guidance is clear and can be applied in a way that effectively communicates to users of financial statements." We have tried to be responsive to the Boards' request as we believe the lack of clarity in several areas creates the potential for wide diversity in application.

As the ED poses very few questions, we have organized our comments in the same order as the proposed standard itself.

Introduction

We believe that including the guidance contained in paragraphs 5 and 6 in the authoritative portion of a standard is detrimental to the application of accounting standards in general. Although the statements in these paragraphs are true, we fail to see why they should be expressly stated in a revenue recognition standard, as they apply equally to just about every other accounting standard. Their inclusion in this proposed standard raises questions about whether there is something unique about revenue transactions that merits such explicit guidance.

For example, wouldn't it always be acceptable, no matter the accounting topic, to account for individual items as a group, as discussed in paragraph 6, if the result of doing so was not materially different than accounting for them individually? Isn't that "practical expedient" equivalent to any other "practical expedient" that an entity might employ in implementing an accounting standard? And isn't it always true, no matter the accounting topic, that an entity should "consider the terms of the contract and all related facts and circumstances" when applying judgment, as stated in paragraph 5? Yet the Boards propose to specifically state these things in this standard when they are not stated in others.

Is the implication that "considering all facts and circumstances" is somehow required to a greater extent in revenue recognition than in other areas of accounting? Or that differences that might be material in other areas of accounting shouldn't be considered material in revenue recognition? Or that other practical expedients are not permitted because they are not expressly stated in the standard?

If the Boards conclude that stating the points in paragraphs 5 and 6 is important, we believe these observations belong in the Basis for Conclusions, not the authoritative portions of the standard.

Scope

We agree with the scope of the ED, and that an entity should apply the relevant portions of this standard to the transfer of a non-financial asset that is not an output of an entity's ordinary activities. We believe that doing so will facilitate comparability and reduce tensions that might otherwise arise regarding whether a particular asset is an output of the entity's ordinary activities.

However, we are concerned that the proposals will leave the accounting for those arrangements scoped out of this project by paragraph 10 of the ED unclear. We believe this paragraph was included in the ED, in large part, to deal with development contracts that are frequently seen in the pharmaceutical industry and in natural resource exploration. We agree with the Boards that in many of those contracts, the parties do not have the characteristics of a traditional vendor-customer relationship, and that the provisions of the ED therefore might not prove useful in depicting those contracts.

Many companies with such contracts currently apply a model that is based in large part on guidance in ASC 605-28, *Milestone Method*, while others analogize to guidance currently included in ASC 980-605-25-5 through 980-605-25-13 on variable payment arrangements in long-term power sales contracts. All of this guidance is proposed to be eliminated, leaving these entities with no guidance to follow. As a result, entities might be in a position where the standard

they are explicitly scoped out of is the only guidance to which they can analogize. That result seems problematic.

We believe that the Boards should consider what guidance might apply to collaborations that are excluded from the proposed standard due to these provisions of paragraph 10. The development of such guidance might best be handled in a separate project.

Contract Modifications

We believe that the revised guidance in the ED is a significant improvement on the guidance in the 2010 ED. This guidance is clearer and more likely to lead to useful financial reporting than the guidance in the 2010 ED.

Identifying Separate Performance Obligations

We note that the Boards do not include in the list of potential performance obligations in paragraph 26 promises by an entity not to take certain actions. We believe it would be helpful for the Boards to address whether such a promise can be a performance obligation and, if so, in what circumstances.

For example, consider an exclusive license of intellectual property. Pursuant to the guidance in the ED, the revenue from an exclusive license is generally recognized at the beginning of the license period, despite the fact that the licensor has agreed to abstain from licensing the technology to others for the term of the license. This suggests that obligations to refrain from participating in a market are not performance obligations.

If so, we wonder what the accounting would be for a covenant not to compete. If the obligation to refrain from competing is not a performance obligation, then it would appear that the entity should recognize revenue (or a gain) immediately upon entering into the contract. We do not believe that this treatment would be consistent with the economic substance of the arrangement.

We believe the Boards should consider whether promises not to take certain actions can be performance obligations and provide some discussion of their views in the final standard.

Satisfaction of Performance Obligations

Performance obligations satisfied over time

We believe that the guidance included in paragraph 35 regarding the determination of whether a performance obligation is satisfied over time is more understandable than the guidance on this point that was in the 2010 ED. However, we believe the guidance in paragraph 35 will greatly increase the situations in which performance obligations to create and deliver goods are treated as being satisfied over time, to the point of producing results that are not transparent in certain situations.

The language which we believe will lead to this outcome is in paragraph 35(b)(iii). This guidance effectively allows revenue recognition during production any time the goods in question are contractually prohibited from being sold to another customer, the vendor expects to fulfill the contract, and the customer has no right to cancel the contract or can only cancel the contract after paying for work performed to date. These factors would exist in most contract manufacturing arrangements or arrangements for the production of specialized goods. We

believe that, as drafted, the ED would allow vendors in such contracts to recognize revenue as they produce the goods in question, regardless of the fact that they have physical possession and legal ownership of the goods, and, absent contract termination by the customer, will not have a right to payment until (and unless) they finish production and deliver the goods to the customer. We do not believe that the customer typically controls the goods in such arrangements during production.

We would instead recommend that the first sentence of paragraph 35(b)(iii) state: "The entity has a present right to non-refundable payment for performance completed to date, or has the right to cease work on this performance obligation and provide the partially-completed asset to the customer in exchange for payment for performance completed to date." The rest of the paragraph could remain as is. We believe that this will avoid inappropriately recognizing revenue during performance when the right to payment and transfer of control of the asset will only occur if and when performance is completed.

Performance obligations satisfied at a point in time

We believe that the factors identified in paragraph 37 are appropriate factors to consider in assessing when performance obligations satisfied at a point in time are completed. However, we have two concerns with the way these factors are discussed.

First, the drafting is likely to result in some practitioners believing that as long as one of the indicators exists, control has passed to the customer. This is because the indicators in 37a, b, and d all include a phrase that sounds determinative. For example, paragraph 37a states that if the entity has a present right to payment, "...then that indicates that the customer has obtained control of the asset." Similarly, paragraph 37b states that "...the transfer of legal title of an asset indicates that the customer has obtained control of the asset." We believe the language in this discussion needs to be softened so that practitioners do not read the guidance as directing that the existence of any one of these factors is determinative as to the transfer of control. Simply replacing the word "indicates" with "may indicate" would accomplish this.

Second, while we are pleased the Boards added consideration of risks and rewards to the guidance regarding transfer of control, we do not believe that the way it has been added will be effective. In our comment letter on the 2010 ED, we noted that we believe that there are situations in which the transfer of control is non-substantive (that is, the customer is essentially indifferent to having control of the products) because the customer has assumed virtually no risks or rewards related to the items it controls. We believe that in situations where control is essentially decoupled from risks and rewards, the transfer of control is not sufficiently substantive to warrant revenue recognition.

We believe, instead, that without a transfer of substantial risks and rewards, revenue should not be recognized. Both Boards have recently completed projects on consolidation. In those projects, the Boards concluded that power is not a sufficient condition to warrant consolidation without exposure to risks and/or rewards. Thus, if the purchaser of an asset housed in an entity obtained power over the entity (and, therefore, over the asset) but had no exposure to risks or rewards, the purchaser would not consolidate the entity (or recognize the asset). We believe that the Boards should similarly conclude that where the customer has not become subject to any significant risks and rewards, control has not been transferred to the customer, and that, therefore, revenue should not be recognized.

Examples of the types of transactions that concern us are:

1. Sales in exchange for the non-recourse debt or sales to a special purpose entity whose ability to pay is solely dependent upon its success in monetizing the asset transferred.
2. Sales to resellers where the seller grants a long return period, price protection, and assistance in finding end-use customers (an in-substance consignment).
3. Seller financed purchases to entities with unusually weak credit.

Customers in these types of transactions have very little incentive and no substantive obligation to pay the promised consideration unless they are able to sell or otherwise monetize the asset transferred. In substance, the transfer of control is not binding if things go poorly.

The ED hints at this issue in paragraph 14(a) via the requirement that a contract have commercial substance. Related paragraph BC34(b) in the Basis for Conclusions also touches on the issue, noting that significant doubt at contract inception about collectibility of consideration may indicate that the buyer is not committed to perform, effectively negating the contract and revenue recognition. While we are encouraged by the inclusion of the language in paragraph BC34(b), it is vague and its intended scope is unclear. In addition, the fact that it is present only in the Basis for Conclusions virtually ensures that it will not be read as limiting revenue recognition.

To ensure that transactions do indeed have commercial substance before revenue is recorded, as contemplated in paragraph 14(a), we believe that revenue should not be recognized unless control and substantial risks and rewards have been transferred. Otherwise, the commercial substance of the transaction is that only the seller is committed to the transaction – the buyer essentially has a no-cost option.

Measuring progress toward complete satisfaction of a performance obligation

We agree with objective stated in paragraph 38 to select a method of measuring progress that depicts the transfer of control of goods or services to the customer. We generally agree that the guidance provided in paragraphs 38-48 of the ED should help to achieve that objective. However, we believe that some of the guidance in those paragraphs and in the Basis for Conclusions encourages the use of cost-to-cost measures of progress where such measures would not faithfully depict the transfer of control of goods or services to the customer.

For example, we agree with paragraph BC118's observation that a units-of-production approach may not be an appropriate measure of progress when both design and production services are provided. However, as written, we believe this language will be applied too broadly because it does not acknowledge the possibility that the design services may not transfer rights to the design to the customer. In our experience, some arrangements that involve both design and production services allow the vendor to retain substantially all the rights to the results of the design services. The customer can use the results of the design work only indirectly, i.e. through the products that are delivered. We believe that the design work in such a situation should not be relevant to revenue recognition, as the design work itself is not transferred to the customer. Rather, the costs of design work should be accounted for under the provisions of ASC 340-10 that relate to preproduction costs related to long-term supply arrangements. The language in paragraphs BC118, particularly when combined with paragraphs BC230-BC232, may lead some to the conclusion that a cost-to-cost method should be used to recognize revenue in such situations, taking design work into account. Of course, where the customer obtains the rights related to the intellectual property as it is created, the design efforts should factor into recognition of revenue.

On a similar note, it is unclear to us how one would determine whether a contract to deliver multiple units of the same good or perform the same service repetitively represents a single performance obligation fulfilled over time or represents multiple performance obligations satisfied at different points in time. Under the 2010 ED, this might not have been a major concern, as the encouraged use of output measures would likely have resulted in similar patterns of revenue recognition. The language in BC230 through BC233, however, makes clear that the “learning curve” can lead to faster revenue recognition if the contract is interpreted as a single performance obligation rather than multiple performance obligations, because an input measure can be used even though an output measure exists, and that input measure can explicitly consider expectations of efficiency gains during the contract. We do not believe this would be an appropriate result. When a contract calls for the repetitive delivery of a good or service (and includes no other performance obligations), we believe the objective of depicting the transfer of control of goods or services to the customer is best met by a method that attributes the same amount of revenue to each repetition.

For example, if an entity agrees to process a customer’s payroll for a period of one year for a fixed fee, we believe that each week’s payroll processing should result in the recognition of the same amount of revenue, even if, as is likely, the vendor becomes more efficient during the contract period. We believe that a method that recognizes revenue on an accelerated basis because of expected efficiency gains would not faithfully depict the transfer of service to the customer. Similarly, in a contract to build and deliver 20 identical machines, the same amount of revenue should be allocated to the transfer of each machine, even if the vendor expects to build machines sequentially and become more efficient along the way. Again, we believe that a method that assigns greater revenue to earlier units delivered would not faithfully depict the transfer of goods to the customer.

In order to discourage the use of cost-to-cost methods of measuring progress when those methods do not depict fairly the transfer of goods or services to the customer, we suggest that the Boards: (i) more clearly tie the requirement to the objective stated in paragraph 38, (ii) refine the discussion in paragraph BC118 to discuss the issue of whether the customer obtains control of the results of the design efforts or not, and (iii) more clearly address the question of determining whether a contract to deliver multiple units of the same good or service is to be treated as one performance obligation or multiple performance obligations.

In addition, because much of the discussion currently in paragraphs BC118 and BC 230-233 is necessary in order to fully understand the provisions of paragraphs 38 to 48, we recommend that it be moved to the authoritative portion of the standard.

Determining the Transaction Price

Variable consideration

We believe the changes from the 2010 ED in regards to taking variable consideration into account in estimating the transaction price are likely to improve both the transparency and operability of the standard.

The time value of money

We generally agree with the ED’s provisions regarding incorporating the time value of money into the revenue recognition model. We believe that the practical expedient in paragraph 60 is an appropriate accommodation that will ease the implementation of the standard without a

substantive loss in transparency or comparability.

We believe that some of the discussion currently housed in the Basis for Conclusions is essential to the understanding and application of the requirements in this area. For this reason, we recommend that the guidance in the last two sentences of BC144 and the discussion in BC146 and 147 be relocated to the authoritative portion of the final standard. Further, BC175 is the only place in the ED that confirms that when a significant financing element exists, costs of uncollectible receivables are not presented in a line item adjacent to revenue. We believe this should also be contained in the authoritative portion of the standard.

We also note that BC155 indicates that the time value of money should be reevaluated if there is a change in the estimated timing of the transfer of goods or services to the customer. Assuming the Boards have concluded that re-evaluation is required, we note that this concept does not appear in the portions of the ED that would be authoritative. However, our view is that such re-evaluation should not occur. To do so would be to recognize a financing component that was not contemplated or bargained for. We do not believe that it is necessary or appropriate to reflect a financing component because of a change in the expected pattern of delivery.

Consideration payable to a customer

We agree with the principles in paragraphs 65-67. However, we believe this topic merits additional examples or implementation guidance. For example, we note that the 2010 ED included an example which indicated that a slotting fee represented a payment for a distinct service. Although we (and many others) disagreed with the conclusion in that example, the elimination of that example and the absence of other common fact patterns provide little indication as to how the Boards believe a slotting fee should be evaluated. Discussion of other common arrangements that result in consideration payable to a customer, such as cooperative advertising campaigns, would also be helpful.

Constraining the Cumulative Amount of Revenue Recognition

We believe that the principle behind this constraint is practical and appropriate. However, we are concerned that the guidance is drafted so broadly that its application may result in significant diversity. We therefore would recommend that additional discussion from the Boards be included in the implementation guidance to increase the likelihood that this constraint will be applied as intended.

We note, for example, that the Boards have concluded that no amount of revenue that is contingent upon a customer's subsequent sale of a good or service is reasonably assured in a license of intellectual property. We are unclear (and understand that various Board members and staff may have differing views) as to whether this is an exception to the principle (as supported by the use of the word "notwithstanding" preceding the explanation of this point in the ED), or an application of the principle. For example, the fact pattern in paragraph IG71 seems to include the same uncertainties that a sales-based royalty in a license of intellectual property would include, yet the Boards have concluded that trailing commissions are reasonably assured even though sales-based royalties are not. This suggests that the guidance in paragraph 85 is an exception. We also are concerned that the guidance in paragraph 85 applies to licenses of intellectual property, but not sales of intellectual property. This apparently arbitrary distinction seems contrary to the FASB's desire to do away with industry-specific revenue recognition standards.

We believe the concept underlying the Boards' limitation on the recognition of variable

consideration is that variable consideration is not reasonably assured if it is contingent upon the actions of a party that is neither the vendor nor the customer in the contract. We believe this concept should apply irrespective of whether the arrangement involves the license of intellectual property. In addition to requiring similar analysis of arrangements with similar contingencies, expanding this principle would also serve to provide a useful example of how the Boards believe the “reasonably assured” language should be applied.

We believe another example of the lack of clarity in this principle is the discussion in paragraph BC 202a. That paragraph starts out noting that “experience with similar types of performance obligations is *necessary* to be able to conclude that the amount of revenue recognized is reasonably assured,” but later states that “...another entity’s experience or other evidence *may be a reasonable proxy* for the entity’s own experience.” (emphasis added) This language appears to negate the “necessity” of experience, while introducing a concept of a “proxy for the entity’s own experience” that is not explained any further.

To illustrate the confusion that we believe exists under the language in the ED, we believe that construction contracts for customer-designed assets would generally be sufficiently unique that relevant experience with “similar contracts” would not exist. Accordingly, we would expect that “other evidence” would be insufficient to be predictive as to the outcome. However, we are aware that others reading the ED believe that the effects of variable consideration for events such as targeted completion dates, bonuses or penalties for being over- or under-budget, and other similar forms of variable consideration could be anticipated even if the asset is unique on the basis that “other evidence” could support the conclusion that the outcome is reasonably assured. Similarly, we believe that contracts such as those considered in ASC 605-28, *Revenue Recognition – Milestone Method*, would almost never lend themselves to reasonable estimates of the transaction price. However, we are aware of differing views.

Onerous Performance Obligations

We agree with the Boards’ conclusion that the revenue recognition model should address the accounting for contracts that contain onerous performance obligations. While we would prefer the test for onerous performance obligations specified in the ED to no test at all, we believe that the test can and should be improved.

First, while we understand the desire to limit the scope of the test for operational reasons, we believe that the creation of a one-year bright line in the standard should be referred to as a practical expedient that allows entities to bypass the test for onerous performance obligations that are of a shorter duration. Just as an entity is not required to implement the practical expedient related to time value of money, an entity should not be prohibited from adopting an accounting policy that recognizes liabilities for shorter-term arrangements that contain onerous performance obligations. As currently worded, the standard would appear to prohibit the recognition of a liability and corresponding expense for performance obligations that are not satisfied over a period that is greater than one year.

Second, we do not believe that the identification of onerous performance obligations should be limited to performance obligations satisfied over a period of more than one year. We believe this will limit the application of the test to a very narrow population of performance obligations because of the focus on the length of the performance period rather than the length of time between the inception of the contract and the completion of the performance. We do not believe there is a strong conceptual reason to limit the onerous test to obligations satisfied over time vs. those satisfied at a point in time. We would suggest that a better scope for the onerous test would be performance obligations that are expected to be completed more than one year after

contract inception. This would capture not only the obligations that are within the scope of the ED's onerous test provisions, but also other onerous obligations that are performed over a short period of time but are contracted for significantly in advance of performance.

Third, we do not believe that allocations of costs should be included in the group of costs used in identifying or measuring onerous obligations. For example, including depreciation in the identification of measurement of an onerous obligation could have the effect of recognizing an asset impairment before such impairment would be recognized under applicable impairment standards. Further, because of the wide variety of ways in which costs can be allocated, we believe the inclusion of allocated costs into the measurement of the liability and expense will introduce significant and unwarranted diversity into practice. We would therefore prefer that the pool of costs used in the onerous test exclude the allocated contract costs described in paragraph 92(c).

Consideration of Anticipated Contracts, Renewals, Extensions, or Optional Purchases

The ED includes inconsistent guidance regarding whether anticipated contract renewals or other optional purchases by the customer can (or must) be included in the various assessments required. The various points where anticipated contract renewals or other optional purchases are mentioned include the following:

- Paragraph 51 states that for the purpose of determining the transaction price, contract renewals may not be considered.
- Paragraph 91 specifically allows contract costs to be capitalized in relation to a specific anticipated contract.
- Paragraph 95 appears to prohibit capitalization of contract origination costs that relate to an anticipated contract because only costs that would not have been incurred in the absence of the contract may be capitalized. Logically, costs incurred before the contract was obtained would not meet that requirement.
- Paragraphs 98-102 allow (if not require) contract renewals to be taken into account when assessing capitalized contract costs for impairment and determining the amortization period for such costs.
- Paragraphs 86-90 appear to prohibit contract renewals from being considered in the onerous test. This is rather confusing, as the same contract costs covered by the impairment and amortization guidance discussed above are considered in the onerous test.
- Paragraph IG24 allows revenue to be allocated assuming optional contract renewals for similar goods or services occur.
- Paragraph IG22, in contrast, generally states that options to purchase additional goods or services are taken into account only if there is a significant incentive for the customer to exercise the option, but even then, only the value of the option is recognized – the additional products or services are not considered performance obligations themselves, unless they are within the scope of paragraph IG24.
- In paragraph BC234, the Boards explicitly state that they are not addressing costs of products produced under long-term production programs. This would appear to leave open the option for entities to apply "program accounting" in which production costs of goods already produced and delivered are allocated to future anticipated contracts.

We believe the inconsistent treatment of anticipated contract renewals and extensions will be confusing, particularly because there is not an explicit principle as to how such options should be thought of in relation to revenue recognition. We believe the Boards need to clearly state their

approach to anticipated contract renewals and options provided to the customer.

Contract Costs

Costs to fulfill a contract

We generally agree with the provisions of paragraph 91 of the ED. We note that the principles stated are consistent with current practice in most regards, and provide a basis for analyzing such costs that currently does not exist in US GAAP. In this regard, we believe that the inclusion of this guidance represents an improvement to the accounting literature.

We do not, however, agree with recognizing an asset related to costs incurred in fulfilling “a specific anticipated contract” as provided in paragraph 91(a). We believe that the definition of an asset is not met until a contract exists, and that capitalizing costs incurred that do not relate to an existing contract is inconsistent with the principles of the ED.

Incremental costs of obtaining a contract

We believe that expensing costs of obtaining a contract would be preferable to the model now proposed.

Disclosure

We believe the guidance in the current ED is improved as compared to the 2010 ED because it eliminates the requirement to provide whatever disclosure is needed to meet a vague and broadly worded objective. The current ED, in contrast, indicates that the objective is achieved by providing the disclosures enumerated in the ED.

While this specific change is an improvement, we continue to be concerned that the level of required disclosures is excessive. Although we are not in a position to identify specific disclosure proposals that should be eliminated, the sheer length of the list of required disclosures compounded by the breadth of products and services offered by many entities leaves us concerned about how an entity could defend its compliance with the disclosure requirements. We recognize that the Boards have planned rather extensive outreach during redeliberations of the proposals in this ED. While we understand the practical limitation of field testing a full implementation of the proposed ED, we would strongly encourage the Boards to attempt a field test of the disclosure requirements so as to better understand the perspective of both preparers and users of financial statements.

Effective Date and Transition

We believe the requirement of retrospective application is both overly burdensome and unrealistic. We believe that there is a reason that none of the revenue recognition standards adopted in the US in recent history required retroactive restatement: it is simply too costly. We believe that retrospective application will be virtually impossible for many companies because they will not have tracked information about necessary components of the accounting. Even a three year deferral of the effective date is insufficient to address the problems preparers face in restating historical periods because it presumes that companies will be able to immediately identify and implement the systems necessary to run a parallel revenue recognition system. While this ED includes some practical expedients that may ease retroactive application, we do not believe that those expedients are sufficient to overcome the

concerns about excessive costs, nor do those expedients mitigate all of the concerns about potential lack of available information.

We continue to believe that, as an alternative, the Boards should consider the transition method provided for in ASU 2009-13, *Multiple-deliverable Revenue Arrangements*.

Warranties

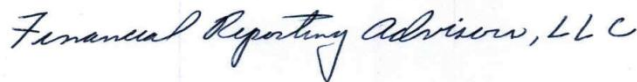
In our comment letter on the 2010 ED, although we indicated that we agreed with the Boards that all warranties should be taken into account in the recognition of revenue, we suggested that, to make the provisions more operational, the Boards should allow companies to use the performance obligation approach for all warranties, rather than attempt to distinguish between the two types.

The current ED retains the classification of warranties into two types, with different treatment for the warranties that cover only latent defects. In substance, the current proposal would be very similar to today's practice in dealing with product warranties. This is not our preference. We believe the Boards' approach to dealing with warranties will give rise to practice problems and diversity because the accounting is based on pragmatism rather than on principle. However, if the Boards retain their approach to accounting for warranties, we recommend that the Boards address the circumstance in which a warranty includes a service in addition to assurance that the product complies with agreed-upon specifications. For example, consider a warranty on an automotive tire that covers "all hazards" for 50,000 miles, such that the warranty is honored even if the damage is clearly caused by the manner in which the product is used, such as running over a sharp object. As written, we do not believe that the ED is clear about how such a warranty would be handled. In our example, where the agreed-upon specifications are framed broadly, should the arrangement be considered a warranty (the product was warranted as being puncture resistant) or a service agreement (i.e. a 50,000 mile insurance policy)?

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Once again we appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Revenue from Contracts with Customers*. If there are any questions, please contact Scott A. Taub at 312-345-9105.

Sincerely,



Financial Reporting Advisors, LLC