January 13, 2014

Mr. Russell Golden, Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

(via e-mail to director@fasb.org)

Re: Collectibility threshold in revenue recognition standard

Dear Mr. Golden:

The International Business Machines Corporation ("IBM" or "the company") would like to comment on the recent Board decisions regarding the collectibility issue in the revenue recognition project. We realize that the final standard is now being drafted, but we are concerned that the proposed collectibility threshold may have unintended consequences that we wanted to bring to the Board's attention.

It's best to describe the issue with an example. Assume that IBM provides a five-year services outsourcing arrangement to a customer. IBM evaluates paragraph 12. in the proposed guidance (fatal flaw draft + proposed amendments) and determines that a contract exists between the company and the customer. Collectibility is determined to be probable in accordance with paragraph 12.f. In the first six months of the contract, the customer is paying amounts billed when due on a non-refundable basis. However, in month seven, the company declares bankruptcy and informs IBM that it does not know when or if it will be able to pay all amounts billed either when due or at all. Because IBM is providing an essential service to the customer without which the customer cannot continue operations, IBM chooses (or is legally required to by court order) to continue to provide services to the customer. After month seven, the customer continues to pay IBM when it is able to, but is paying approximately 50 percent of invoices several months after the required due dates.

Under current SEC guidance, collectibility would not be reasonably assured in this scenario, and revenue would be recognized only when cash was received from the customer. However under the new guidance, we are having difficulty applying paragraphs 12. and 15. to the scenario above to account for the cash collections received after the customer declared bankruptcy. We are unsure whether we would be able to recognize revenue as billed with a corresponding adjustment to the allowance for doubtful accounts, revenue as cash is collected or revenue for the cash collected only upon termination of the contract.

If IBM assumes that a change in facts and circumstances has occurred as per paragraph 15.2 which would indicate that collectibility is not probable, then we understand the guidance to state that IBM would no longer have a valid contract with the customer as per paragraph 12., and IBM would have to defer all revenue from that point until all obligations were satisfied or the contract terminated which would in this scenario be as much as 4.5 years from the time the cash was collected. To us, this would be highly counter-intuitive since the company continued to satisfy its performance obligations to the customer and has received non-refundable cash. In addition, IBM is continuing to incur costs to provide the service to the customer throughout the contract which will be recognized as the service is being provided. However, paragraph 12.f is very limiting since it states that in order for collectibility to be probable, the customer has to have the ability and intention to pay amounts when due. In our scenario, they would only have the ability to partially pay amounts, but not necessarily when due, so IBM would technically "fail" the collectibility threshold in paragraph 12.f.

If collectibility were deemed probable as per paragraph 15.2, there would still be confusion around how much revenue to recognize. Under the proposed guidance, IBM would then still have a valid contract with the customer, and we would be able to recognize revenue as invoiced under step 3 of the model. (This is also assuming that no concessions would be granted to the customer.) Any adjustments to collectibility would then be reflected in bad debt expense/ allowance for doubtful accounts. This would be a significant change from current GAAP since 100 percent of amounts billed would be recognized as revenue.

There may be a third way to interpret this to say that 50 percent of amounts billed are deemed collectible, and only those amounts would be recognized as revenue when received. IBM would then essentially recognize the same amount of revenue as under current GAAP. In our reading of the proposed guidance in paragraphs 12. and 15., we have difficulty in reaching that conclusion, which we feel would be the best depiction of revenue recognition for this contract.

The answer can't be to recognize nonrefundable partial consideration received only when there are no remaining performance obligations, all the consideration is received and the contract is terminated. This results in delayed revenue recognition that does not depict the actual cash flows that are occurring in this contract. Therefore, we feel that there needs to be additional guidance to address the issue of collectibility in regard to partial collections.

If you have any questions or wish to discuss any topic further, please do not hesitate to contact me at 914-766-2008.

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