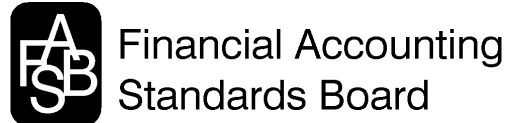


MINUTES



To: Board Members

From: Revenue Recognition Team
(Kazazean, ext. 327)

Subject: Minutes of the February 26, 2003 Board Meeting **Date:** February 28, 2003

cc: Leisenring, Bielstein, T. Johnson, Smith, Petrone, MacDonald, Mahoney, Swift, Polley, Thompson, Gabriele, Sutay, Patton (GASB), Slayton, Such, Manders, Wilson, Kazazean, Cohen, Cropsey, Lapolla, Intranet

Topic: The Definition of Revenues

Basis for Discussion: Memorandums dated February 13, 2003 and February 25, 2003

Length of Discussion: Starting Time: 10:30 a.m. Concluding Time: 11:45 a.m.

Attendance:

Board members present: Herz, Crooch, Foster, Trott, Schipper, Wulff

Board members absent: Schieneman

Staff in charge of topic: Johnson

Other staff at Board table: Bielstein, Slayton, Cropsey, Such, Manders, Wilson,
Kazazean

Outside participants: None

Summary for ACTION ALERT:

The Board continued its discussion of issues related to the definition of revenues in the context of the reporting entity's performance obligations to its customers. The Board

compared two views, one in which revenues arise from the extinguishment of those obligations, and another in which revenues arise from the entity's performance of those obligations. The Board indicated a preference for the view that revenues arise from the extinguishment of performance obligations unless those obligations are legally assumed by a third party. In that regard, the Board agreed that the notion of a *primary obligor*, which is integral to the preferred view, should be consistent with its meaning in FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The Board directed the staff to further clarify the similarities and differences between the two views and to provide additional examples of the application of these views.

Matters Discussed and Decisions Reached:

Mr. Johnson began the discussion by noting that, at the January 22, 2003 Board meeting, the Board considered issues related to the definition of revenues in the context of a reporting entity's performance obligations to its customers. The Board focused on two views at that meeting, one in which revenues arise from the extinguishment of those obligations (the "liability extinguishment view"), and another in which revenues arise from the entity's performance of those obligations (the "broad performance view"). Mr. Johnson noted that at today's meeting the Board would discuss a comparison of those two views. The criteria used in comparing the views are the qualitative characteristics in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, of relevance, comparability, and reliability, together with consideration of the constraint that the costs of the information provided should not exceed its benefits.

Mr. Johnson continued by explaining that the term *primary obligor* is integral to applying the liability extinguishment view. That term is utilized both in EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent," and Statement 140, but with somewhat different interpretations. Under Issue 99-19, the primary obligor is seen in a broader, more general sense, whereas under Statement 140 the primary obligor is seen more narrowly in a legal sense. Mr. Johnson noted that the differences in those interpretations were illustrated in four cases relating to Issue 99-19 that the staff had analyzed for the meeting.

Mr. Johnson also explained that one of the cases prepared for the Board’s consideration at today’s meeting involves insurance enterprises. That case illustrates how the liability extinguishment view might alter the revenues that some insurance enterprises report. Insurance companies currently net certain of their revenues and expenses, particularly those related to the insurance risks that they have written and subsequently reinsured. However, due to state regulations, those companies generally continue to be the primary obligor with respect to the risks they have written. For that reason, applying the liability extinguishment view to those companies would likely increase the amount of revenues reported.

Mr. Foster indicated that he objects to the liability extinguishment view because he believes that the objective of revenue recognition is to present an indication of activities during the period. Mr. Foster stated that the liability extinguishment view does not provide useful information for this objective, and he expressed a preference for the broad performance view.

Ms. Schipper indicated that she supports the liability extinguishment view and noted that guaranteeing a party’s performance and finding a third party to legally assume your obligation are different economic events and the liability extinguishment view would provide transparency into this difference through the amount of revenue recognized. She indicated her belief that it is important to look at the details of a commercial contract to identify which party has an obligation for performance. Ms. Schipper also noted that some participants at the User Advisory Council meeting indicated a preference for revenues to represent the “size of activities” for a company. She added that the insurance example indicates that scoping insurance companies out of the comprehensive standard on revenue recognition would result in the existence of a significant “outlier.”

Mr. Trott expressed his support for the liability extinguishment view. He noted that the top line of revenues should convey the results of contracts between reporting entities and their customers and how the related performance obligations are settled. Mr. Trott indicated that revenue recognition under this view raises complex issues as to when the liability is extinguished and when there are three-party transactions. Mr. Trott added that

the insurance example challenged the present practice of reporting items “gross” in the balance sheet and “net” in the income statement.

Mr. Wulff also expressed his support for the liability extinguishment view. He expressed an interest in additional disclosure or display of internally performed versus externally outsourced revenue generating activities as well. He also indicated that users of financial statements want market-share information and better insight into the size of obligations borne by an entity.

Mr. Herz and Mr. Crooch also expressed support for the liability extinguishment view. Mr. Crooch asked the staff to provide more examples of actual commercial arrangements.

Overall, the Board indicated a preference for the view that revenues arise from the extinguishment of performance obligations unless those obligations are legally assumed by a third party [5 Board members agreed: EWT, RHH, KAS, GMC, JKW; 1 did not: JMF]. In that regard, the Board generally agreed that the notion of a *primary obligor*, which is integral to the preferred view, should be consistent with its meaning in Statement 140. The Board directed the staff to provide additional clarification regarding revenue recognition under the two revenue recognition views discussed at this meeting. In addition, the Board asked the staff to expand three-party transactions such as the cases involving the travel discounter and the consolidator to include specific facts involving actual commercial arrangements and the legal terms of the contracts.

Follow-up Items:

None

General Announcements:

None