

MINUTES



To: Board Members

From: Revenue Recognition Team
(Ham, ext. 443)

Subject: Minutes of the April 9, 2008 Board Meeting: Revenue Recognition **Date:** April 22, 2008

cc: FASB: Bielstein, Golden, MacDonald, Cospers, Lott, Posta, T. Johnson, Wilks, Bement, Vessels, Ham, Reager, Zeyher, Zhu, Nickell, Yust, Bolash, C. Smith, Glotzer, Mechanick, Gabriele, Chookaszian, Klimek, Allen, Sutay, FASB Intranet; IASB: Leisenring, Rees, Pitman, Hickey, Upton, Clark, Peerless, Knubley; AASB: Paul; GASB: Patton, Driscoll, Reese

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement, Interpretation, or FASB Staff Position.

Topic: Revenue Recognition: Drafts of Chapters 2, 3, and 4 for the Discussion Paper

Basis for Discussion: Board Memorandums No. 106–109

Length of Discussion: 8:30 to 9:45 a.m.

Attendance:

Board members present: FASB: Herz, Batavick, Crooch, Linsmeier, Seidman, Smith, and Young

IASB: Leisenring

Board members absent: None

Staff in charge of topic: Wilks

Other staff at Board table: FASB: Bielstein, T. Johnson, Bement, Ham, and Reager

Participation by phone: IASB: Pitman

Summary of Decisions Reached:

The Board discussed drafts of Chapters 2, 3, and 4 for the upcoming discussion paper on revenue recognition. These chapters cover accounting for contracts with customers and the identification and satisfaction of performance obligations. The Board was not asked to make any decisions. Instead, the Board offered suggestions for improving the draft chapters of the discussion paper.

In particular, the staff was asked to consider how the proposed revenue recognition model could be articulated based on the existing definition of an asset, rather than the Boards' working definition from the conceptual framework project. The staff was also asked to explain the alternative view held by some Board members that revenue cannot arise at contract inception. There were a number of other editing suggestions offered by the Board, but, generally speaking, the Board agreed with the staff's approach in the upcoming revenue recognition discussion paper.

Objectives of Meeting:

The objectives of the meeting were for the Board to discuss whether the drafts of Chapters 2, 3, and 4 are sufficiently complete and clearly explained for purposes of a discussion paper and whether the main alternative views are appropriately captured. The discussion was for informational purposes only and the Board was not asked to vote on any topics. The objectives were met.

Matters Discussed and Decisions Reached:

1. Mr. Wilks opened the meeting by explaining the context of Chapters 2, 3, and 4 relative to the rest of the discussion paper. Following the discussions on accounting for contracts with customers and the identification and satisfaction of performance obligations, Chapter 5 will cover measurement of contracts at initial recognition and whether to subsequently remeasure contracts. Chapter 6 considers how revenue is displayed in financial statements, including the effect of remeasurements on the statement of comprehensive income. Chapter 7 considers the need to improve disclosures on revenue recognition. Chapter 8 is the final chapter and it considers the issues the Board

will still need to address to implement the proposed model. There will also be an appendix that will illustrate how the proposed model would apply to numerous examples, including some emerging issues the IFRIC and the EITF recently discussed.

Accounting for Contracts with Customers (Chapter 2 Draft)

2. Mr. Wilks started the discussion by explaining the changes that the staff has made to this chapter since the earlier draft discussed by the Boards in November 2007. He invited comments from the Board on those changes and any other issues related to the draft of Chapter 2.

3. Mr. Batavick stated that he prefers *arrangements* with customers as opposed to *contracts* with customers. He believes it is a better indication of retail sales and that the word *contract* implies that something in writing is needed. However, he acknowledged that other Board members seem to support the term *contract*. Thus, his recommendation is to move that description of what the Boards mean by *contract* from paragraph 42 closer to paragraph 27 so that it is very clear to the reader that a written contract is not necessary. In addition, he requested that the staff emphasize that retail sales are captured in this model.

4. Mr. Batavick also noted that he disagrees with paragraph 40. He believes that revenue cannot arise at contract inception because the entity has not yet performed and a performance obligation has not been satisfied. Mr. Smith agreed and requested that this alternative view be included in the discussion paper. Mr. Wilks confirmed that the staff would make this addition.

5. Mr. Linsmeier questioned whether recognizing revenue at contract inception was a measurement issue or a conceptual issue. Messrs. Batavick and Smith and Ms. Seidman responded that, for them, it is a conceptual issue. Mr. Linsmeier stated that he disagrees with their concept and that it is a measurement issue. Revenue-generating activities such as developing a business model and advertising start well before a contract has been arranged or signed. Often, getting the customer is the key event, so there should be at least a possibility of revenue at contract inception.

6. Mr. Leisenring asked Mr. Smith if his disagreement with revenue recognition at contract inception was actually an issue of labeling because he believes an entity has to “perform” for revenue. Further, Mr. Leisenring asked Mr. Smith whether he would feel comfortable recognizing a gain instead of revenue. Mr. Smith indicated that he is primarily troubled by revenue recognition since the entity has not yet done anything, but he did not say whether he would be willing to recognize a gain.

7. Mr. Leisenring countered that if an entity has to do something to receive revenue, then contributions for a not-for-profit entity are not revenue. Mr. Smith responded that a not-for-profit entity has a general obligation to spend the money for its intended purpose and that he thinks contributions for not-for-profits are revenue, not gains. Ms. Seidman observed that the scope of this project is arrangements with customers, so contributions for not-for-profit entities are not within the scope as there are no customers involved. Furthermore, this project does not rule out other methods of reporting revenue in circumstances that do not involve customers.

8. Mr. Herz agreed with Ms. Seidman and asked whether the staff was going to include in the discussion paper before Chapter 2 a section on recognizing revenue outside of contracts with customers. He noted that under current GAAP, securities firms can include as part of their trading revenues unrealized gains on financial instruments not associated with specific customers. Mr. Wilks responded that the staff had not planned to address this issue in depth at the beginning of the paper. Instead, the staff was going to discuss it in Chapter 8, which covers other issues.

9. Next, Ms. Seidman requested that paragraphs 9 and 10 be revised to explain how deferred debits and credits relate to the definitions of assets and liabilities. She also noted that she does not agree that there is a “conflict,” as the title of that section implies, because deferred debits and credits arising from rights and obligations within a contract currently meet the definitions of assets and liabilities. Mr. Wilks agreed that this section could be better written to clarify that deferred debits and credits that do not meet the definitions of assets and liabilities are outside of the contract.

10. Before moving on to the next chapter, Mr. Linsmeier gave an example of a general contractor putting together a set of bids from subcontractors before even bidding on the customer's work. By the time the contractor is awarded the contract, a considerable amount of work necessary to the project has already been done. Conceptually, there should be revenue at inception of the contract, and this example is not that different from other contracts and arrangements covered under the proposed model. At the same time, contract inception revenue is not always easy to measure, and one consequence of inaccurate measurement is front-loading profit. Therefore, he believes it is a measurement issue, not a conceptual issue.

11. Mr. Leisenring noted that certain contracts, such as the one in Mr. Linsmeier's example, are saleable to a third party. Therefore, there is clearly something of value at contract inception. He questioned whether Board members really believe such contracts are worth nothing, and, thus, there is no revenue at inception. Mr. Batavick stated that he views this as an intangible asset that cannot be recorded under current GAAP.

Performance Obligations (Chapter 3 Draft)

12. Mr. Wilks explained the changes the staff has made to this chapter since the earlier draft discussed by the Boards in January 2008. He invited comments from the Board on those changes and any other issues related to the draft of Chapter 3.

13. Ms. Seidman stated that she thinks promotional promises are not performance obligations because they are not part of the agreement with the customer according to the description of an *agreement* in paragraph 49 of the draft of Chapter 2. Rather, they are firm offers by the entity to give a discount if and when the customer buys something in the future.

14. Mr. Wilks responded by noting that the promotional promises in the music example are part of the current transaction. In other words, the customer agreed to pay a certain amount of money for both the music player and the gift or discount card. Ms. Seidman requested that the staff revise the example to make it very clear that the promotional

promises are part of the contract. Mr. Wilks confirmed that the staff would make this change.

15. Next, Mr. Batavick asked why the staff defined a performance obligation in terms of transferring an economic resource and then explained that goods and services are economic resources. He questioned why a performance obligation was not defined simply in terms of transferring a good or service. Mr. Wilks responded that it is important to explain it in that way because it is consistent with the Boards' tentatively accepted definition of an asset. Furthermore, that definition of an asset, which includes the notions of enforceable rights and access, provides useful guidance for determining when an economic resource transfers to the customer and a performance obligation is satisfied.

16. Mr. Leisenring suggested that the staff perform an analysis using the existing definition of an asset to see if the model produces the same results as it does with the proposed definition of an asset. Mr. Wilks noted that this would be a worthwhile exercise and mentioned including such an analysis in an appendix to the discussion paper.

Satisfaction of Performance Obligations (Chapter 4 Draft)

17. Mr. Wilks explained the changes the staff has made to this chapter since the earlier draft discussed by the Boards in January 2008. He invited comments from the Board on those changes and any other issues related to the Chapter 4 draft.

18. Mr. Linsmeier observed that this chapter was hard to follow because some of the examples skip the identification of performance obligations and go straight to the satisfaction of performance obligations. To be clear and not misleading, he suggested that the staff revise the examples to include complete identification of all performance obligations even if the examples then only focus on a particularly troublesome obligation. Mr. Wilks agreed and confirmed that the staff would change the examples accordingly.

19. Mr. Linsmeier also stated that customer acceptance seems very similar to rights of return, but the staff's analyses of the two issues are very different. Mr. Wilks explained that in most situations in which customer acceptance clauses arise, the customer cannot

simply refuse the good or service like it can with a right of return. The customer can only require that the entity re-perform or perform additional work until his specifications are satisfied. Mr. Linsmeier noted that some rights of return have restrictions, so customer acceptance is just an example of that type of right of return. Mr. Wilks stated that the staff would add a clarification to Chapter 4 explaining how customer acceptance is different from a right of return.

20. Next, Mr. Herz noted that the model appears to be very legalistic, especially in contrast to the continuous approach in the EFRAG paper to be discussed at the upcoming joint Board meeting. Form seems to override substance when using terms like *enforceable right* and *contract*. He asked the staff for its thoughts on this observation. Mr. Wilks responded that the terminology is derived from the Boards' working definition of an asset and that by focusing on that definition, the model is much more precise than the EFRAG paper, which is unclear as to what asset or liability triggers revenue recognition.

21. Mr. Herz asked the staff if it could add a discussion on substance of transactions and that the satisfaction of performance obligations does not necessarily have to be driven by legalities in the contract. Mr. Wilks responded that the staff would add this to the discussion paper and analogize to the EFRAG paper.

22. Ms. Seidman stated that she struggled with the example of the consulting company preparing a special report because it seemed like an argument to capitalize transaction costs. She views it as a service, not a finished intangible good. Mr. Wilks responded that the staff agrees that there is no easy answer for this example given the proposed model's focus. Since the model focuses on the transfer of economic resources, examples like this are very difficult because the customer may not actually receive an economic resource until the final product is delivered. Thus, some contracts that have traditionally been thought of as services may be goods under this model.

23. Ms. Seidman suggested that if the end result of a transaction has fleeting value (for example, a report that is used to make a decision and then discarded), that is an indication of a service, not a good. Mr. Wilks disagreed with this suggestion and stated that such an

indicator could be applied to any good or service that is immediately consumed. Mr. Linsmeier noted that the consulting example could be described as a service that is delivered in one chunk as opposed to continuously over time. Ms. Seidman agreed that this might be a better way of approaching the example. She also noted that the example could be changed to something that everyone agrees would qualify for capitalization.

24. Mr. Wilks concluded the meeting by stating that the staff would work to include the Board's views on these issues as it revises the discussion paper.

Follow-up Items:

None.

General Announcements:

None.