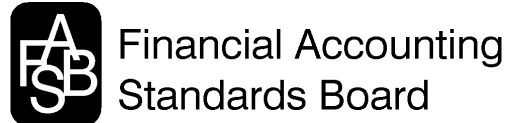


MINUTES



To: Board Members

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

Subject: Minutes of the July 23, 2003 Board Meeting **Date:** July 29, 2003

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

Topic: Revenues and Contractual Rights and Obligations

Basis for Discussion: Memorandum dated July 10, 2003

Length of Discussion: Starting Time: 9:00 a.m. Concluding Time: 9:30 a.m.

Attendance:

Board members present: FASB: Herz, Crooch, Schipper, Seidman, Trott (by phone)

Board members absent: Schieneman (sent comments)

Staff in charge of topic: Johnson

Other staff at Board table: Slayton, Cropsey, Sletten, Kazazean, Belot

Outside participants: J. Paul (IASB)

Summary for ACTION ALERT:

The Board continued to discuss a conceptual model for analyzing assets and liabilities arising from contracts and contractual rights and obligations. Specifically, the Board addressed enforceability of contracts and the implications

that different legal remedies might have for the recognition of assets and liabilities, including the unit of account.

The Board tentatively agreed that contracts that are not enforceable do not meet the definitions of assets and liabilities. Unless a contract is enforceable, the obligations that it imposes on the contracting parties will not meet the definitions of liabilities, and the corresponding rights that it conveys to counterparties will not meet the definitions of assets.

The Board noted that the subjects of most contracts are fungible, although the subjects of some contracts are unique. The Board also noted that the usual legal remedy is money damages for breaches of wholly or partially executory contracts in which the subjects are fungible, and that those contracts are in some respects akin to financial contracts that are or can be settled on a net basis in cash. The Board tentatively agreed that the unit of account for an executory contract in which the subject is fungible should be the contract as a whole. The Board further noted that the legal remedy can be specific performance for breaches of wholly or partially executory contracts in which the subjects are unique, and that those contracts are in some respects akin to financial contracts that are settled physically. The Board tentatively agreed that the unit of account for an executory contract in which the subject is unique should be the assets and liabilities arising from the unconditional contractual rights and obligations in that contract.

The Board asked the staff to prepare illustrations of the conceptual model by applying it to examples relating to existing guidance, including the guidance for long-term construction contracts, for discussion at a future meeting.

Matters Discussed and Decisions Reached:

The Board continued to discuss a conceptual model for analyzing assets and liabilities arising from contracts and contractual rights and obligations.

The Board tentatively agreed with the staff's recommendation that contracts that are not enforceable do not meet the definitions of assets and liabilities. Unless a contract is enforceable, the obligations that it imposes on the contracting parties will not meet the definitions of liabilities, and the corresponding rights that it conveys to counterparties will not meet the definitions of assets. However, Board members expressed concern about the use of legal terminology in determining a contract's enforceability, noting that it could cause difficulty in applying the standard outside of the United States, which is undesirable in a joint project with the IASB. The Board supported an approach that could be applied in many jurisdictions, such as basing the model on commercial substance and using commercial rather than legal terminology and distinctions.

The Board also discussed two general legal remedies, specific performance and monetary damages, in the context of determining the unit of account in accounting for pre-performance assets and liabilities relating to wholly or partially executory contracts. Board members noted that monetary damages are the legal remedy in most instances.

The staff noted that legal remedies are the last resort in settling executory contracts prior to performance. The remedy of money damages results in an asset to only one party to a contract and a liability to only the other party. That suggests the unit of account in accounting for such contracts should be the contract as a whole. In contrast, specific performance results in assets and liabilities to both parties to a contract. That suggests the unit of account should be the assets and liabilities that arise from the unconditional rights and obligations conveyed in the contract.

One Board member noted the similarity with the derivatives standard regarding contracts that can be "net settled," stating that both deal with market variables and that, if a contract can be net cash settled, it should be viewed as a net contract. However, other Board members cautioned against analogizing too

closely to derivatives. Board members also expressed caution about analogizing too closely to legal terminology.

One Board member expressed concern about the operationality of an approach that would divide contracts into different parts and different stages, noting that there could be difficulty in measuring the resulting assets and liabilities.

Another Board member questioned whether gross or net reporting for contracts would have any implications for deciding between the liability extinguishment view and broad performance view of revenues. The staff responded that it would not.

Several Board members observed that even when the unit of account is the contract as a whole, the net effect at the outset for the reporting entity may be an asset because the fair values of the unconditional rights that it obtains under the contract may exceed the fair values of the unconditional obligations that it incurs. For example, that difference may reflect the entity's selling effort.

The Board tentatively agreed that when the subject of an executory contract is fungible, the unit of account should be the contract as a whole and when the subject is unique, the unit of account should be the assets and liabilities arising from the unconditional contractual rights and obligations.

Board members asked the staff to prepare illustrations of the conceptual model by applying it to examples relating to existing guidance, including the guidance for long-term construction contracts, for discussion at a future meeting.

Follow-up Items:

At a future meeting, the staff will present the Board with examples based on existing guidance to illustrate the concepts discussed.

General Announcements:

None.