Financial Accounting
Standards Board

Revenue Recognition Roundtable Meeting
April 26, 2012
1:00 p.m–4:00 p.m.

Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut

AGENDA

Welcome and introductions

We have arranged this roundtable meeting to listen to your views and to develop further our understanding of the issues you raise or alternatives you propose in your comment letters.

We expect to cover each of the following topic areas:

- Topic 1: Performance obligations satisfied over time
- Topic 2: Constraining the cumulative amount of revenue recognized
- Topic 3: Disclosure
- Topic 4: Other (where applicable):
    a) Separate performance obligations
    b) Onerous performance obligations
    c) Allocating the transaction price
    d) Transition
    e) Time value of money.

We plan to spend 35–40 minutes per topic (depending on interest) and will then allow some time for all participants to raise any additional issues they would like to discuss at the end of the session.

Topic 1: Performance obligations satisfied over time

ED proposals

35. An entity transfers control of a good or service over time and, hence, satisfies a performance obligation and recognizes revenue over time if at least one of the following two criteria is met:

(a) The entity's performance creates or enhances an asset (for example, work in process) that the customer controls as the asset is created or enhanced. An entity shall apply the proposed guidance on control in paragraphs 31–33 and paragraph 37 to determine whether the customer controls an asset as it is created or enhanced.

(b) The entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and at least one of the following criteria is met:

> (i) The customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs.
>
> (ii) Another entity would not need to substantially reperform the work the entity has completed to date if that other entity were to fulfill the remaining obligation to the customer. In evaluating this criterion, the entity shall presume that another entity fulfilling the remainder of the contract would not have the benefit of any asset (for example, work in process) presently controlled by the entity. In addition, an entity shall disregard potential limitations (contractual or practical) that would prevent it from transferring a remaining performance obligation to another entity.
>
> (iii) The entity has a right to payment for performance completed to date, and it expects to fulfill the contract as promised. The right to payment for performance completed to date does not need to be for a fixed amount. However, the entity must be entitled to an amount that is intended to at least compensate the entity for performance completed to date even if the customer can terminate the contract for reasons other than the entity's failure to perform as promised. Compensation for performance completed to date includes payment that approximates the selling price of the goods or services transferred to date (for example, recovery of the entity's costs plus a reasonable profit margin) rather than compensation for only the entity's potential loss of profit if the contract is terminated.

36. When evaluating whether an asset has an alternative use to the entity, an entity shall consider at contract inception the effects of contractual and practical limitations on the entity's ability to readily direct the promised asset to another customer. A promised asset would not have an alternative use to an entity if the entity is unable, either contractually or practically, to readily direct the asset to another customer. For example, an asset would have an alternative use to an entity if the asset is largely interchangeable with other assets that the entity could transfer to the customer without breaching the contract and without incurring significant costs that otherwise would not have been incurred in relation to that contract. Conversely, the asset would not have an alternative use if the contract has substantive terms that preclude the entity from directing the asset to another customer or if the entity would incur significant costs (for example, costs to rework the asset) to direct the asset to another customer.

<u>Main discussion points</u>:

- The concept of control and paragraph 35(b)
- Assets that do not have an alternative use because of contractual restrictions
- Identifying whether an entity has a right to payment for performance to date
- Recognizing revenue for service contracts whereby each unit of service is distinct and for license arrangements with bundled services.

Topic 2: Constraining the cumulative amount of revenue recognized

ED Proposals

81. If the amount of consideration to which an entity expects to be entitled is variable, the cumulative amount of revenue the entity recognizes to date shall not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount of consideration allocated to satisfied performance obligations only if both of the following criteria are met:

(a) The entity has experience with similar types of performance obligations (or has other evidence such as access to the experience of other entities).

(b) The entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.

85. Notwithstanding the requirements in paragraphs 81–83, if an entity licenses intellectual property (see paragraph IG33) to a customer and the customer promises to pay an additional amount of consideration that varies on the basis of the customer's subsequent sales of a good or service (for example, a sales-based royalty), the entity is not reasonably assured to be entitled to the additional amount of consideration until the uncertainty is resolved (that is, when the customer's subsequent sales occur).

Main discussion points:

- Use of the phrase *reasonably assured*
- Constraining the amount of revenue recognized, e.g., effect on pattern of revenue recognition
- Accounting for consideration that varies based on a customer's subsequent sales.

Topic 3: Disclosure

ED Proposals (summarized)

The proposed requirements specify various disclosure requirements that would enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity would disclose qualitative and quantitative information about all of the following:

(a) Its contracts with customers (including a reconciliation of contract balances)

(b) The significant judgements, and changes in judgements, made in applying the proposed requirements to those contracts

(c) Any assets recognized from the costs to obtain or fulfil a contract with a customer.

ED proposals for disclosure in interim financial statements

The Boards propose to amend IAS 34 and Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports. The disclosures that would be required (if material) are:

- The disaggregation of revenue (paragraphs 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- An analysis of the entity's remaining performance obligations (paragraphs 119–121)
- Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
- A tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfil a contract with a customer (paragraph 128).

Main discussion points:

- Availability of information needed to comply with the proposals
- Characteristics of contracts or industries for which the proposed disclosures would not provide relevant information
- Disclosure of revenue in the context of interim reporting principles.

Topic 4: Other

(a) Separate performance obligations

ED Proposals

28. Except as specified in paragraph 29, a good or service is distinct if either of the following criteria is met:

(a) The entity regularly sells the good or service separately.

(b) The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer. Readily available resources are goods or services that are sold separately (by the entity or by another entity) or resources that the customer already has obtained (from the entity or from other transactions or events).

29. Notwithstanding the requirements in paragraph 28, a good or service in a bundle of promised goods or services is not distinct and, therefore, the entity shall account for the bundle as a single performance obligation if both of the following criteria are met:

(a) The goods or services in the bundle are highly interrelated and transferring them to the customer requires that the entity also provide a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted.

(b) The bundle of goods or services is significantly modified or customized to fulfill the contract.

30. As a practical expedient, an entity may account for two or more distinct goods or services promised in a contract as a single performance obligation if those goods or services have the same pattern of transfer to the customer. For example, if an entity promises to transfer two or more distinct services to a customer over the same period of time, the entity could account for those promises as one performance obligation if applying one method of measuring progress (as discussed in paragraphs 38–48) would faithfully depict the pattern of transfer of those services to the customer.

Main discussion points:

- Accounting for separate performance obligations: the interaction between paragraphs 28–30
- The meaning of a *significant integration service* and the addition of paragraph 29(b).

(b) Onerous performance obligations

ED Proposals

86. For a performance obligation that an entity satisfies over time (see paragraphs 35 and 36) and that the entity expects at contract inception to satisfy over a period of time greater than one year, an entity shall recognize a liability and a corresponding expense if the performance obligation is onerous.

87. A performance obligation is onerous if the lowest cost of settling the performance obligation exceeds the amount of the transaction price allocated to that performance obligation. The lowest cost of settling a performance obligation is the lower of the following amounts:

(a) The costs that relate directly to satisfying the performance obligation by transferring the promised goods or services (those costs are described in paragraph 92)

(b) The amount that the entity would pay to exit the performance obligation if the entity is permitted to do so other than by transferring the promised goods or services.

Main discussion points:

- Justification for a revenue standard specifying an onerous test
- Scope of the onerous test
- Unit of account for the onerous test (e.g., the performance obligation, the contract, or a higher unit of account)

(c) Allocating the transaction price

ED Proposals

70. For a contract that has more than one separate performance obligation, an entity shall allocate the transaction price to each separate performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation.

71. To allocate an appropriate amount of consideration to each separate performance obligation, an entity shall determine the stand-alone selling price at contract inception of the good or service underlying each separate performance obligation and allocate the transaction price on a relative stand-alone selling price basis. […]

72. The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. […]

73. If a stand-alone selling price is not directly observable, an entity shall estimate it. […] Suitable estimation methods include, but are not limited to, the following:

(a) Adjusted market assessment approach—an entity could evaluate the market in which it sells goods or services and estimate the price that customers in that market would be willing to pay for those goods or services. That approach might also include referring to prices from the entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins.

(b) Expected cost plus a margin approach—an entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service.

(c) Residual approach—if the stand-alone selling price of a good or service is highly variable or uncertain, then an entity may estimate the stand-alone selling price by reference to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract. A selling price is highly variable when an entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts. A selling price is uncertain when an entity has not yet established a price for a good or service and the good or service has not previously been sold.

…

75. An entity shall allocate a discount entirely to one (or some) separate performance obligation(s) in the contract if both of the following criteria are met:

(a) The entity regularly sells each good or service (or each bundle of goods or services) in the contract on a stand-alone basis.

(b) The observable selling prices from those stand-alone sales provide evidence of the performance obligation(s) to which the entire discount in the contract belongs.

Main discussion points:

- Practical issues associated with estimating stand-alone selling prices
- Use of the residual approach
- Allocation of discounts.

(d) Transition

ED Proposals

132. An entity shall apply this proposed guidance retrospectively by applying the requirements on accounting changes in paragraphs 250-10-45-5 through 45-10, subject to the expedients specified in paragraph 133. In the period of adoption, an entity shall provide the disclosures required in paragraphs 250-10-50-1 through 50-3.

133. An entity may use one or more of the following practical expedients when applying this proposed guidance. For the purposes of the expedients, the date of initial application is the start of the reporting period in which an entity first applies the proposed guidance.

(a) For contracts completed before the date of initial application, an entity need not restate contracts that begin and end within the same annual reporting period.

(b) For contracts completed before the date of initial application and that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.

(c) An entity need not evaluate whether a performance obligation is onerous before the date of initial application unless an onerous contract liability was recognized previously for that contract in accordance with the requirements that were effective before the date of initial application. If an entity recognizes an onerous contract liability at the date of initial application, the entity shall recognize a corresponding adjustment to the opening balance of retained earnings for that period.

(d) For all periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue (as specified in paragraph 119).

Main discussion points:

- Cost of transition
- Retrospective application.

(e) Time value of money

ED Proposals

58. In determining the transaction price, an entity shall adjust the promised amount of consideration to reflect the time value of money if the contract has a financing component that is significant to the contract. The objective when adjusting the promised amount of consideration to reflect the time value of money is for an entity to recognize revenue at an amount that reflects what the cash selling price would have been if the customer had paid cash for the promised goods or services at the point that they are transferred to the customer. If the promised amount of consideration differs from the cash selling price of the promised goods or services, then the contract also has a financing component (that is, interest either to or from the customer) that may be significant to the contract.

59. In assessing whether a financing component is significant to a contract, an entity shall consider various factors including, but not limited to, the following:

(a) The expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services

(b) Whether the amount of consideration would differ substantially if the customer paid in cash promptly in accordance with typical credit terms in the industry and jurisdiction

(c) The interest rate in the contract and prevailing interest rates in the relevant market.

60. As a practical expedient, an entity need not adjust the promised amount of consideration to reflect the time value of money if the entity expects at contract inception that the period between payment by the customer of all or substantially all of the promised consideration and the transfer of the promised goods or services to the customer will be one year or less.

61. To adjust the promised amount of consideration to reflect the time value of money, an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract as well as any collateral or security provided by the customer or the entity, which might include assets transferred in the contract. An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the cash selling price of the good or service. After contract inception, an entity shall not update the discount rate for changes in circumstances or interest rates.

62. An entity shall present the effects of financing separately from revenue (as interest expense or interest income) in the statement of comprehensive income.

<u>Main discussion points</u>:

- The requirement to account for time value of money (TVM)
- Definition of *significant financing component* and the determination of when a financing component is "significant"
- Application of TVM to the revenue side of a transaction without considering how it may affect the cost side of the transaction
- Practical expedient for the TVM.

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IFRS

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Joint Public Roundtable Meeting
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FASB Office, 401 Merritt 7, Norwalk, CT
1:00 p.m.–4:00 p.m.

Participants

Dima Andriyenko	PCAOB
Mark Bamford	Textron
Jennifer Bourgeois	State Street
Marc Foley	National Football League
Russell Hodge	FEI/CCR; General Electric
James Lacey	AT&T
Joe Longino	Sandler O'Neill
Tamara Mathis	KPMG
Jenifer Minke-Girard	Securities and Exchange Commission
Grace Mullings	Toyota Motor Credit corporation
Ryan Siurek	Sprint Nextel
Kathleen Skero	The Blackstone Group
Lynne Triplett	Grant Thornton
Robert Uhl	Deloitte and Touche

FASB Participants

Leslie Seidman	Board Chairman
Russ Golden	Board Member
Tom Linsmeier	Board Member
Hal Schroeder	Board Member
Larry Smith	Board Member
Sue Cosper	Technical Director
Peter Proestakes	Assistant Director
Kristin Bauer	Practice Fellow (Project Lead)
Phil Hood	Project Manager
Liz Gagnon	Assistant Project Manager
Mike Breen	Practice Fellow
Buck Bagwell	Postgraduate Technical Assistant
Tom Skoglund	Postgraduate Technical Assistant

IASB Participants

Prabhakar "PK" Kalavacherla	Board Member
Henry Rees	Associate Director
Glenn Brady	Senior Technical Manager
Allison McManus	Senior Technical Manager