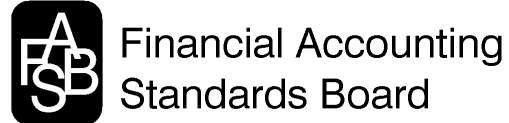


MINUTES



To: Board Members

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

Subject: Minutes of the May 14, 2008 Board Meeting: Revenue Recognition **Date:** May 28, 2008

cc: FASB: Bielstein, Golden, MacDonald, Posta, Cospers, Lott, 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: Draft of Chapter 5 for the Discussion Paper

Basis for Discussion: Board Memorandums No. 110–111

Length of Discussion: 9:00 to 10:15 a.m.

Attendance:

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

Board members absent: Young

Staff in charge of topic: Wilks

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

IASB: Rees

Participation by phone: IASB: Pitman

Summary of Decisions Reached:

The Board discussed a draft of Chapter 5, “Measurement of the Contract,” for the upcoming discussion paper on revenue recognition. The Board suggested a number of changes for both the structure and content of the chapter. In addition, the Board voted on the two measurement approaches and expressed a preliminary view in favor of the customer consideration approach. The customer consideration approach (a) measures performance obligations at the price (or value of the consideration) promised by the customer at contract inception and (b) subsequently remeasures performance obligations only if they become onerous.

Objectives of Meeting:

The objectives of the meeting were for the Board to (a) discuss whether the draft of Chapter 5 is sufficiently complete and clearly explained for purposes of a discussion paper and whether the main strengths and weaknesses of the two measurement objectives and remeasurement are appropriately captured and (b) vote on the two measurement approaches to determine a preliminary view. The objectives were met.

Matters Discussed and Decisions Reached:

Measurement of the Contract (Chapter 5 Draft)

1. Mr. Wilks started the discussion by explaining that the measurement of the contract is fundamental to the proposed revenue recognition model for two reasons. First, measurement determines whether the contract is recognized. Second, measurement determines the amount of revenue that is recognized as performance obligations are satisfied. He invited comments from the Board on the draft chapter.
2. Mr. Batavick provided his view that both the construction and content of the Chapter 5 draft needed improvement. He observed that the discussion in the chapter seems unbalanced and biased toward the current exit price approach. He also stated that the discussion does not capture the essence of the customer consideration approach, which is that the customer consideration or sales price represents the actual agreed-upon

exchange price and cash flows expected to be received by the seller from the satisfaction of the seller's performance obligations. He noted that this results in more relevant and meaningful information than a hypothetical lay-off price under the current exit price approach. In other words, the customer consideration approach captures what was actually transacted versus what could have been transacted. Therefore, an actual, not a theoretical, margin is captured.

3. Furthermore, Mr. Batavick believes that the customer consideration approach is easier to communicate, understand, and implement. He believes that selling effort is an ongoing selling, general, and administrative expense necessary to run the business. Consequently, there is no asset or revenue to be recognized when a contract is entered into in normal arrangements with customers. Lastly, he thinks there is too much emphasis on onerous contracts as these will be the exception rather than the rule.

4. Mr. Smith observed that one of the strengths of the current exit price approach described in the chapter is that it gives a more faithful representation of the performance obligation. He stated that this ignores the representation of the contract, which is more fundamental than the representation of the performance obligation. In his opinion, the customer consideration approach provides the most faithful representation of the contract itself. Mr. Smith also noted that he does not agree with the assertion in the chapter that the current exit price approach provides a more faithful representation of the economics of the contract. The economics of the contract are that the entity agreed to provide a product or service and, at inception of the contract, the entity has done nothing to fulfill its performance obligations.

5. Mr. Linsmeier noted that it is difficult to understand the strength and weakness assertions in the chapter without seeing how the two measurement approaches would report revenue and present information about contracts with customers. In the customer consideration approach, revenue always equals the amount originally contracted with the customer. In the current exit price approach, reported revenue also could equal the amount originally contracted with the customer if price changes are reported separately in

the income statement. Mr. Wilks acknowledged that the staff could combine the presentation and display chapter with the measurement chapter.

6. Mr. Linsmeier also stated that he thinks that the onerous contract test should not be part of the sales price measurement objective. He believes that whether or not there needs to be an onerous contract test should be a separate decision after the measurement objective is chosen. Along the same lines, Mr. Linsmeier suggested making decisions for the preliminary view on all aspects of measurement separately rather than voting on the collection of decisions in the two measurement approaches. He noted that this might also help the organization of the paper and the presentation of strengths and weaknesses. Finally, Mr. Linsmeier expressed his concern that remeasurement for revenue is only one half of remeasurement. He stated that an incomplete and potentially misleading picture is provided by remeasuring revenue if inventory is not remeasured as well.

7. Next, Ms. Seidman expressed her desire to see the rationale for the customer consideration approach stated in the positive. In other words, she wants to see a discussion in the chapter about the beliefs of the supporters of the customer consideration approach. The chapter is missing the basic rationale that the contract reflects a meeting of the minds between the seller and the customer about the value of goods or services being exchanged. Therefore, in total, the contract amount represents the obligation that has been incurred by the seller. She believes that this is relevant and understandable.

8. Ms. Seidman also noted that the total customer consideration equals the selling price, which equals the total cash flows. She believes this is highly predictive of the sustainability of revenue for the reporting entity. Supporters of the customer consideration approach think that the actual margins of the entity are more relevant and more useful than hypothetical market margins. If there is a need for information about trends with respect to changing prices of contracts or of costs to fulfill obligations, this information could be provided in disclosures. Mr. Herz agreed with Ms. Seidman's comment about disclosures.

9. Ms. Seidman stated that there is an overemphasis in the chapter on the net loss situation under the customer consideration approach. Furthermore, that discussion is

overly focused on sales commissions paid upfront at inception of the contract. She observed that the customer consideration approach never intended to address the “lumpiness” of expenses because, in a going concern, it will even out over time. This should not be described as a weakness of the approach in the paper. In addition, the paper should not imply that the Board will revisit the issue with capitalization and deferrals because this is not its intention.

10. Regarding the section in the paper on consistency with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, Ms. Seidman stated that she views contracts with customers as different from other forms of uncertain liabilities because they are negotiated and the parties have agreed on the price. This is different from a lawsuit or another contingency in which estimation is required. Ms. Seidman noted that she would solve the problem by removing sales of goods or services with customers from the scope of IAS 37.

11. Moving on, Mr. Linsmeier observed that paragraph 33 focuses only on the direct and indirect costs of obtaining a customer. However, he noted that entities have significant precontracting costs, and the sales price charged to the customer yields a margin that covers both the costs of obtaining the customer and precontracting costs. This should be explained and made clear in the paper. Mr. Wilks stated that this issue will be included in the expanded discussion on the customer consideration approach requested by some Board members earlier in the meeting.

Chapter 5 Draft Appendices

12. Ms. Seidman stated that she does not support including the appendix on an alternative measurement approach (Appendix A). She believes that the questions in the discussion paper will elicit sufficient responses about alternative approaches. Other Board members agreed.

Preliminary View on Measurement

13. Mr. Wilks asked the Board whether it prefers the customer consideration measurement approach or the current exit price measurement approach, as articulated in

the draft chapter. Four Board members (Batavick, Herz, Seidman, and Smith) voted for the customer consideration approach as articulated, emphasizing that they would not favor any remeasurement in this model except for onerous contracts. Messrs. Linsmeier and Crooch voted for an exit price measurement objective, but with no remeasurement. This view departed from the current exit price approach articulated in the draft chapter, which required remeasurement of the contract at each reporting date. Mr. Young voted by proxy for (a) the current exit price approach in businesses with observable markets for standardized, common, or interchangeable items and (b) the customer consideration approach in businesses with highly differentiated products, little exchangeability, or large expense for uncertain customer acquisition.

14. Given the Board's preliminary view in favor of the customer consideration approach (which does not allow remeasurement), Mr. Wilks asked the Board whether there are circumstances in which it would still want to remeasure performance obligations. Four Board members (Batavick, Herz, Seidman, and Smith) reiterated that they do not support any remeasurement except for onerous contracts. Mr. Linsmeier stated that if there is remeasurement for revenue, there needs to be remeasurement for inventory as well. Mr. Crooch agreed with Mr. Linsmeier.

Follow-up Items:

None.

General Announcements:

The project on assets held for sale to amend the measurement guidance in FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, has been removed from the agenda.