Financial Accounting Standards Board

Board Meeting Handout

Revenue Recognition

March 20, 2013

Purpose

1. At the February 20, 2013 joint Board meeting, the Boards discussed the proposed disclosure, transition, effective date, and early application requirements in the Exposure Draft, R*evenue from Contracts with Customers* (2011 ED) as they would apply to public entities. The purpose of this meeting is to discuss:

    a. For nonpublic entities, the disclosure, transition, effective date, and early application requirements of the revenue standard, and

    b. For public entities, the FASB to reconsider the effective date following the tentative decision reached at the February 2013 joint Board meeting.

Definition of a Nonpublic Entity

2. Consistent with the 2011 ED, the term *nonpublic entity* will include an entity that does not meet the following conditions.[1]

    a. Its debt or equity securities trade in a public market either on a stock exchange (domestic or foreign) or in an over-the-counter market, including securities quoted only locally or regionally.

    b. It is a conduit bond obligor for *conduit debt securities* that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets).

[1] Defined in the *FASB Accounting Standards Codification*® Master Glossary

c. It files with a regulatory agency in preparation for the sale of any class of debt or equity securities in a public market.

d. It is required to file or furnish financial statements with the Securities and Exchange Commission.

e. It is controlled by an entity covered by criteria (a) through (d).[2]

Input from Nonpublic Entity Stakeholders

3. The staff performed outreach to obtain feedback from nonpublic entity stakeholders, including financial statement users, preparers, and auditors on the 2011 ED. Input was received through the following channels:

   a. Comment letter responses

   b. Targeted outreach and educational activities including:

      (i) Nonpublic entity roundtable (Salt Lake City, Utah)

      (ii) Industry-specific workshops

      (iii) Nonpublic entity webcast

      (iv) Meetings with nonpublic entity stakeholders.

      (v) Meetings with the Small Business Advisory Committee, Private Company Financial Reporting Committee (PCFRC), Private Company Council (PCC), NFP Advisory Committee, the AICPA Technical Issues Committee, and the AICPA Not-for-Profit Expert Panel

   c. Other conferences and meetings (including meetings with state CPA societies, industry groups and trade associations).

4. The staff performed additional outreach with nonpublic entity stakeholders, including members of the PCC about the amendments and clarifications made at

[2] Note: Based on the Boards tentative decisions reached in the definition of a nonpublic entity project, a private company that is a consolidated subsidiary of a public company would no longer be considered a public entity.

the February 2013 joint Board meeting relating to disclosures, transition, effective date, and early application. Feedback received on each issue is included within the relevant sections of the handout.

5. Additionally, the staff prepared a summary of feedback received from nonpublic entities for the Board's consideration at its February joint Board meeting.

Issue 1: Annual Disclosures

6. The disclosure requirements are outlined in paragraphs 109–130 of the 2011 ED. Specifically the following are required:

    a. Disaggregation of revenue (paragraphs 114–116)

    b. Reconciliation of contract balances (paragraph 117)

    c. Performance obligations, including the remaining performance obligation disclosure (paragraphs 118–121)

    d. Significant judgments in the application of the proposed guidance, including discussion of determining the timing of satisfaction of performance obligations and determining the transaction price and the amounts allocated to performance obligations (paragraphs 124–127)

    e. Assets recognized from the costs to obtain or fulfill a contract with a customer (paragraphs 128 and 129).

2011 ED requirements for nonpublic entities

7. Paragraphs 116 (disaggregation of revenue) and 130 of the 2011 ED indicate that nonpublic entities may elect not to provide the following proposed disclosures:

> 116. A nonpublic entity need not apply the proposals in paragraphs 114 and 115. Rather, a nonpublic entity shall disclose qualitative information about how economic factors (such as type of customer, geographical location of customers, and type of contract) affect the nature, amount, timing, and uncertainty of revenue and cash flows. A nonpublic entity shall disaggregate revenue in accordance with the timing of transfer of goods or services (for example, revenue from goods or services transferred

to customers at a point in time and revenue from goods or services transferred over time).

130. A nonpublic entity may elect not to provide any of the following disclosures:

(a) A reconciliation of contract balances (paragraph 117)

(b) 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 (paragraph 119)

(c) A reconciliation of liability balances recognized from onerous performance obligations (paragraph 123)

(d) A reconciliation of asset balances recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128)

(e) An explanation of the judgments, and changes in judgments, used in determining the timing of satisfaction of performance obligations (paragraphs 125 and 126) and in determining the transaction price and allocating it to performance obligations (paragraph 127).

Overall feedback from nonpublic entity stakeholders

8. Overall, most nonpublic entity stakeholders support the proposed disclosure exemptions for nonpublic entities because these respondents indicate that many of the proposed disclosure requirements are not cost-beneficial for users of nonpublic entity financial statements. However, a few users expressed concern about providing different disclosure requirements for nonpublic entities because the needs of financial statement users are not driven by organizational differences.

9. Since the February 2013 joint Board meeting, the staff conducted additional outreach on annual disclosures with members of the PCC. Of the PCC members with whom outreach was performed, all of those PCC members support the proposed disclosure exemptions for nonpublic entities, even after considering the clarifications and amendments made by the Board to those disclosures at the February 2013 joint Board meeting. For disaggregation of revenue, the majority of the PCC members support the qualitative aspects of the disclosure, but they do

not think that requiring nonpublic entities to comply with the quantitative aspects is cost-beneficial in all cases.

Disaggregation of revenue (paragraphs 114–116 of the 2011 ED as amended at the February 2013 joint Board meeting)

10. Some nonpublic entity respondents to the 2011 ED expressed concern about the intention of the proposed disclosure about disaggregation of revenue. These respondents indicate that information about the timing of transfer of goods or services may not depict the best representation of the nature, amount, timing, and uncertainty of revenue and cash flows of their entity (for example, geographical area may provide a better representation). Therefore, these respondents suggested that the Board either (a) exempt nonpublic entities from this requirement or (b) permit nonpublic entities to choose another form of disaggregation that may provide more useful information to their users and, hence, clarify that a nonpublic entity can disaggregate revenue in the same manner as public entities. Additionally, some respondents questioned whether or not the disaggregation disclosure requirements for nonpublic entities would be satisfied by a qualitative disclosure as compared to a quantitative disclosure similar to public companies.

11. Some users of nonpublic entity financial statements have stated that information about disaggregation of revenue could provide useful information depending on what information is conveyed. Those users indicated that they are most interested in understanding revenue that is predictable and recurring. For example, a technology company may charge a monthly license fee and also have advisory services or implementation fees. However, some users of nonpublic entity financial statements that require disaggregated revenue information, such as investors and sureties, indicated that they already receive this information directly from management outside of the audited financial statements. Given that many investors in nonpublic entities hold significant ownership interests and board positions, they commonly receive disaggregated revenue information from management on a monthly or quarterly basis.

12. Some users of nonpublic entity financial statements stated that the current disclosure requirements in Topic 275, Risks and Uncertainties, that addresses concentration of risks provide sufficient information. Others have indicated concerns that the proposed disclosures may not provide useful information in all circumstances based on the flexibility allowed under the proposal.

13. The majority of preparers and auditors of nonpublic entity financial statements who shared their views are concerned with the difficulty and costs to compile and audit disaggregated revenue information because many nonpublic entities state that currently they do not have the systems and processes in place to enable them to present revenue on a disaggregated basis. In addition, some preparers and auditors of nonpublic entity financial statements indicated that nonpublic entities are concerned that providing disaggregated revenue information may disclose proprietary information.

14. Some preparers and auditors of nonpublic entity financial statements noted that the proposed disaggregation requirement in the 2011 ED is similar to the required disclosures under Topic 280, Segment Reporting, which are not required for nonpublic entities. The basis for conclusions in FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information* (Topic 280), states that "few users of nonpublic enterprises financial statements have requested that the Board require that those enterprises provide segment information."

Question 1: Disaggregation of revenue (as amended at the February 2013 joint Board meeting)

Does the Board agree to:

a) Affirm its tentative decision in the 2011 ED that a nonpublic entity should disclose qualitative information about how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors;

b) Clarify that a nonpublic entity may elect not to comply with the quantitative proposals of disaggregating revenue in paragraphs 114 and 115; and

c) Clarify that if a nonpublic entity elects not to comply with the quantitative proposals of paragraphs 114 and 115, then a nonpublic entity should, at a minimum, disclose quantitative information about the disaggregation of revenue in accordance with the timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time)?

Disclosure of contract balances and costs (paragraphs 117, 119–121, and 128-129 of the 2011 ED as amended at the February 2013 joint Board meeting)

15. Paragraph 130 of the 2011 ED indicates that nonpublic entities are exempt from providing the following disclosures:

    a. Reconciliation of contract balances (paragraphs 117)

    b. The amount of transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue (paragraph 119)

    c. Assets recognized from the cost to obtain or fulfill a contract with a customer (paragraph 128).

Contract balances disclosure (paragraph 117) and cost disclosure (paragraph 128)

16. The majority of respondents to the 2011 ED supported the exemptions from providing reconciliation information indicated in paragraphs 117 and 128 of the 2011 ED. The majority of preparers and auditors of nonpublic entity financial statements are concerned about the level of detail and costs associated with compiling and auditing roll forward information. Some preparers have stated that many nonpublic entities may not have the necessary information readily available.

17. Most users of nonpublic entity financial statements are primarily focused on disclosures affecting cash and given their ability to access management, they typically can receive additional information about the changes in a particular account. Therefore, many users have stated that they do not find all roll forward information decision useful and they are concerned about disclosure overload.

18. Based on the decisions reached at the February 20, 2013 joint Board meeting, the disclosures required in paragraphs 117 and 128 of the 2011 ED have been modified to replace the reconciliation requirements with a combination of quantitative and qualitative disclosures. Many nonpublic entity stakeholders and PCC members indicate continued support for the exemptions in paragraphs 117 and 128 even after considering the amendments made by the Boards at the February 2013 joint Board meeting. Similar feedback was received indicating concerns about the costs associated with compiling and auditing the information and concerns about the volume of disclosures. Because most users of nonpublic entity financial statements are able to access management, they typically can request additional information about the changes in a particular account, if necessary. In addition, some of the information required by the disclosures in paragraphs 117 and 128 of the 2011 ED can be located in other parts of the financial statements or captured in other disclosure requirements (for example, an explanation of how the entity's contracts and typical payment terms will affect the entity's contract balances could be provided by the requirements in paragraph 118 about significant payment terms of performance obligations).

Question 2: Contract balances and cost disclosures (as amended at the February 2013 joint Board meeting)

Does the Board agree to affirm its tentative decisions reached in the 2011 ED that a nonpublic entity may elect not to provide the disclosure requirements about:

a) Contract balances (paragraph 117 of the 2011 ED, as amended at the February 2013 joint Board meeting), and

b) The assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128 of the 2011 ED, as amended at the February 2013 joint Board meeting)?

Disclosure of remaining performance obligations (paragraph 119 of the 2011 ED as amended at the February 2013 joint Board meeting)

19. Many nonpublic entity preparers and auditors commented that it would be difficult and costly to prepare and audit this disclosure. Some noted that existing

accounting systems are not designed to track and capture this information, including the details about the timing of the satisfaction of those remaining performance obligations.

20. Some users of nonpublic entity financial statements stated that they often receive similar information directly from management in greater detail than what is being proposed. For example, some nonpublic entities provide their sureties with supplemental schedules in addition to the audited financial statements that include information about contracts in progress as well as contracts completed during the period. These schedules often include information about revenue, costs, and gross margin. Therefore, this disclosure could result in redundant information that may not provide additional benefit to some users of nonpublic entity financial statements. Some preparers of nonpublic entities have indicated concerns about disclosing forward-looking information that may be proprietary.

Question 3: Disclosure of remaining performance obligations (as amended at the February 2013 joint Board meeting)
Does the Board agree to affirm its tentative decision reached in the 2011 ED that a nonpublic entity may elect not to 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 (paragraph 119 of the 2011 ED as amended at the February 2013 joint Board meeting)?

Disclosure of judgments, assumptions, methods, and inputs (paragraphs 124–127 of the 2011 ED as amended at the February 2013 joint Board meeting)

21. Paragraphs 124–127 of the 2011 ED proposes that an entity disclose information about judgments, and changes in judgments, that significantly affect the determination of the amount and timing of revenue from contracts with customers. Paragraph 130 of the 2011 ED indicates that nonpublic entities are exempt from the specific requirements in paragraphs 125–127 of the requirements.

22. Many users of nonpublic entity financial statements have stated that disclosure of accounting policy information does not provide them with useful information unless (a) the entity has an option to select among acceptable alternatives, (b) the entity has a significant policy change, or (c) it is the year of initial adoption of a new standard. Many users indicated that this type of information results in disclosure overload. Other users, particularly lenders, stated that they do not require details about the underlying accounting because they are placing reliance on management's views and estimates and the auditor's report to ensure that the financial statements are not materially misstated and that the statements are reported in accordance with U.S. GAAP.

23. As indicated in the draft Private Company Decision-Making Framework (PCDMF), some users of nonpublic entity financial statements have indicated that notes about judgments and assumptions could be more valuable and less lengthy if they focused more on the facts rather than management's views and estimates so that users can further discuss the matters with management and arrive at their own conclusions.

24. Some users of nonpublic entity financial statements may not need additional detail and other users can generally obtain additional underlying information directly from management if required.

Question 4: Disclosures about judgments, assumptions, methods, and inputs (as amended at the February 2013 joint Board meeting)
Does the Board agree: (a) To affirm its tentative decisions in the 2011 ED that a nonpublic entity shall comply with the requirement in paragraph 124 that an entity disclose the judgments, and changes in the judgments, made in applying the proposed guidance that significantly affect the determination of the amount and timing of revenue from contracts with customers, and (b) That a nonpublic entity may elect not to provide the specific disclosures in paragraphs 124(a–b) and paragraphs 125–127 as amended at the February 2013 joint Board meeting?

Interim Disclosures

25. At the February 2013 joint Board meeting, the FASB tentatively decided to retain the proposal in the 2011 ED to amend Topic 270 to require an entity to provide the quantitative disclosures proposed in the 2011 ED (including any tentative amendments to those quantitative disclosures made at the February 2013 joint Board meeting) in its interim financial statements. Those quantitative disclosures (as tentatively amended) are:

    a. Disaggregated revenue

    b. The opening and closing balances of contract assets, contract liabilities and receivables from contracts with customers (if not separately presented)

    c. The amount of revenue recognized in the current period that was included in the contract liability balance

    d. Those that relate to the entity's remaining performance obligations, and

    e. Any adjustment to revenue in the current period that relates to performance from a performance obligation satisfied (or partially satisfied) in a previous period.

26. Paragraph BC368 of the 2011 ED indicates that the Board decided not to specify disclosures that a nonpublic entity should include in its interim financial statements.

27. The majority of nonpublic entity stakeholders, including all PCC members with whom the staff performed outreach with, supported the Board's proposal not to specify interim disclosures for nonpublic entities. The staff thinks that the disclosure of revenue information in interim financial statements has limited relevance to nonpublic entities because:

    a. Typically nonpublic entities do not prepare interim U.S. GAAP financial statements including footnote disclosures

b. Many users of nonpublic entity financial statements already receive supplemental revenue information on a monthly or quarterly basis based on their individual needs. Furthermore, because many of those users have direct access to management, they often are able to request additional information from management, and

c. The Board is proposing that nonpublic entities should be required to disclose only some general qualitative information about revenue and its contracts with customers (which would be qualitative information that may remain fairly constant) and some limited quantitative disaggregation of that revenue (subject to the Boards decisions to questions 1–4 of this handout).

Question 5: Interim Disclosures
Does the Board agree to affirm its tentative decision reached in the 2011 ED <u>not</u> to amend Topic 270 to specify interim disclosures on revenue from contracts with customers for nonpublic entities?

Transition

28. The transition requirements of the revenue standard are included in paragraphs 132–134 of the 2011 ED and were amended at the February 2013 joint Board meeting. The 2011 ED did not prescribe an alternative transition method for nonpublic entities. However, the Board considered whether to provide nonpublic entities with an alternative method to apply the transition requirements in the 2011 ED. The Board acknowledged that nonpublic entities are not required under U.S. GAAP to include comparable periods in their financial statements. However, the FASB noted that if a nonpublic entity includes comparable periods in its financial statements, then it is important that revenue be recognized consistently for both periods presented.

29. Most preparers and auditors of nonpublic entity financial statements share many of the same concerns raised by preparers and auditors of public entity financial

statements about the retrospective application proposal in the 2011 ED (see Memo 167E). The majority of these stakeholders state that they disagree with the requirement to apply the revenue standard retrospectively. Those stakeholders note that retrospective transition would not be operational in many cases and the costs to comply would be significant.

30. Most lenders to nonpublic entities have stated that they require a minimum of two years of comparable financial information because they need this input for their lending assessment models and in making credit decisions. However, some of those lenders indicated that they would be willing to accept a prospective application of the revenue standard because of cost-benefit concerns if (a) the effect on comparability was not significant or (b) upon request, management directly provides them with comparable unaudited financial information. Other users have stated that retrospective application may have little benefit to other types of users of nonpublic entity financial statements relative to the costs that may be incurred.

31. Some nonpublic entity stakeholders suggested that the concerns about applying the revenue standard retrospectively can be mitigated by providing nonpublic entities with an extended implementation period such as two to three years beyond the effective date for public entities. While the preparers and auditors that served on the PCFRC strongly favored the prospective method of transition, the committee recognized the importance of the lender's needs in evaluating cost-benefit considerations for private company financial statements. Therefore, the PCFRC recommended requiring disclosure of the retroactive effect of the revenue standard.

32. The staff discussed the transition requirements of the revenue standard with the PCC at its February 2013 meeting. Most of the PCC members indicated a preference for the alternative transition method that was decided by the Board at its February 2013 joint Board meeting.

Question 6: Transition
Does the Board agree to affirm its tentative decision reached in the 2011 ED not to prescribe an alternative method of transition for nonpublic entities?

Effective Date and Early Application

Effective date for public entities

33. At the February 2013 joint Board meeting, the Boards tentatively decided to require an entity to apply the revenue standard for annual reporting periods beginning on or after January 1, 2017 and interim periods therein. The Boards noted that the period of time from the expected issuance of the standard until its effective date is longer than usual. However, in this case the Boards decided that a delayed effective date is appropriate because of the unique attributes of the Revenue Recognition project, including the scope of entities that will be affected and the potentially significant effect that a change in revenue recognition has on other financial statement line items.

34. For IFRSs, the IASB typically sets effective dates of on or after January 1 or on or after July 1. Comparatively, the FASB typically sets effective dates based on a mid-month convention to ensure that the implementation period is essentially the same for both (a) entities with reporting period end dates that are near *but not on* the last day of a month (for example, companies applying a 52-53 week fiscal year), and (b) entities with month-end reporting period end dates (eg companies with a calendar year end). To identify the number of SEC reporting entities that would be affected by an *other-than* mid-month effective date, the staff performed searches on SEC filings. The staff's goal was to identify the approximate number of recent SEC reporting entities that have a year-end that is *prior to* and *close to,* but not on, December 31. The staff identified between 70 and 100 entities that met this criterion and which span a variety of industries, such as the hospitality, entertainment, and life sciences industries. A January 1 effective date effectively provides this relatively small subset of SEC filers an additional year for

implementing an accounting standards update that is not available to companies with a calendar year end.

Question 7: Effective Date for Public Entities
Does the Board want to set an effective date: (a) For annual reporting periods beginning on or after January 1, 2017, including interim reporting periods therein (affirm the Boards' tentative decision for effective date at the February 2013 joint Board meeting), or (b) For annual reporting periods beginning after December 15, 2016, including interim reporting periods therein?

Effective date and early application for nonpublic entities

35. Paragraph 131 of the 2011 ED indicates that "the effective date for nonpublic entities will be a minimum of one year after the effective date for public entities." At the February 2013 joint Board meeting, the Boards discussed effective date and early application and decided to require a public entity to apply the revenue standard for annual reporting periods beginning on or after January 1, 2017, including interim periods therein. The alternatives presented in this handout for the effective date applicable to nonpublic entities will depend on the FASB's redeliberation about effective date in question 7 of this handout for public entities.

36. Nearly all nonpublic entity stakeholders indicated support for the minimum one-year deferral proposed in the 2011 ED for nonpublic entities, particularly if there is a long transition period provided to implement the final standard. However, some of those stakeholders think that a deferral for an additional year (that is, a total of two years) will be necessary if they are required to apply the revenue standard retrospectively. They believe that additional time is necessary to allow such entities to evaluate the effect of the revenue standard and make the necessary changes to apply it. The majority of the members of the PCC support an effective

date that is one year after the first annual period for which public companies are required to adopt the revenue standard.

Alternatives

37. The staff has identified the following alternatives for when nonpublic entities should apply the revenue standard:

a. **Alternative 1:** Annual reporting periods beginning after December 15, 2017 [on or after January 1, 2018 pending the Boards' decision to question 7], including interim periods therein (one-year deferral)

b. **Alternative 2:** Annual reporting periods beginning after December 15, 2017 [on or after January 1, 2018 pending the Boards' decision to question 7] and interim and annual periods thereafter (one year deferral after the first annual period required for public entities)

c. **Alternative 3:** Annual reporting periods beginning after December 15, 2018 [on or after January 1, 2018 pending the Boards' decision to question 7], including interim periods therein (two-year deferral).

Question 8: Effective Date and Early Application Nonpubilc Entities

(a) Does the Board agree that nonpublic entities should apply the requirements in the revenue standard for the first annual period beginning after December 15, 2017 (pending the Boards' decision to question 7), and interim and annual periods thereafter (one year after the first annual period for which public entities are required to adopt the requirements in the revenue standard), and

(b) A nonpublic entity can elect to apply the requirements of the revenue standard no earlier than annual reporting periods beginning after December 15, 2016 (pending the Boards' decision to question 7), including interim periods within as required for public companies?