MINUTES

To: Board Members

From: Revenue Recognition Team
(B. Wilson, ext. 275)

Subject: Revised Minutes of the January 22, 2003 Board Meeting

Date: January 24, 2003

cc: Leisenring, Bielstein, T. Johnson, Smith, Petrone, MacDonald, Mahoney, Swift, Polley, Thompson, Gabriele, Sutay, Patton (GASB), Slayton, Such, Manders, B. Wilson, Cohen, Cropsey, Lapolla, Intranet

Topic: The Definition of Revenue and Performance of Revenue-Generating Activities

Basis for Discussion: Memorandum dated January 10, 2003 and handout dated January 14, 2003

Length of Discussion: Starting Time: 9:00 a.m. Concluding Time: 10:00 a.m.

Attendance:

Board members present: FASB: Herz, Crooch, Foster, Trott, Schieneman, Schipper, and Wulff

Board members absent: None

Staff in charge of topic: Johnson

Other staff at Board table: Bielstein, Slayton, Such, Manders, Wilson, Kazazean

Outside participants: None

Summary for ACTION ALERT:

The Board considered issues related to the definition of revenues in the context of a reporting entity's performance obligations to its customers. The Board focused on two views, one in which revenues arise from the extinguishment of those obligations, and another in which revenues arise from the entity's performance of those obligations. The Board directed the staff to compare the advantages and disadvantages of those views and to explore issues related to basing revenues on the extinguishment of obligations, as well as related displays that might be coupled to such revenue measures to reflect the entity's performance.

Matters Discussed and Decisions Reached:

Mr. Johnson began the discussion by noting that the current "working definition" of revenue for this project broadly encompasses both revenues and gains. He also noted that the staff recommended at the December 18, 2002 FASB Board meeting incorporating the notions of performance and revenue-generating activities in the working definition of revenues. Including those notions would be a means of addressing the revenue recognition issues raised in cases in which a third party performs the obligations that a reporting entity has incurred to its customers, among other issues.

Mr. Johnson continued to explain that discussions of performance and revenue-generating activities by the FASB and IASB during their December meetings revealed differing perceptions on what revenue is. Board members expressed four possible views of what revenue is: (View A) a "gross inflow view," (View B) a "liability extinguishment view," (View C) a "value added view," and (View D) a "broad performance view." Mr. Johnson indicated that the Board could choose one of those views to further refine the definition of revenue so as to make it a more robust conceptual tool for addressing revenue recognition issues. Alternatively, the Board could choose to view revenue as more of a display matter. Under this alternative, there might be several different kinds of "revenues" displayed in financial statements, with each conveying somewhat different information.

The staff recommended that the Board not pursue Views A and C or the display approach and instead focus on the advantages and disadvantages associated with Views B and D. Mr. Johnson noted that View A would result in recognizing revenue for performance obligations that have been legally assumed by others. He also noted that View C would essentially limit the amount of revenue that an entity would recognize to its gross margin, which would seem to provide less information and be a significant change to existing practice. He added that the principal difference between Views B and D concerns treatment of performance obligations that are performed by third parties that have not legally assumed those obligations. Under View B, revenue would be recognized in such situations by the reporting entity, whereas under View D, revenue would be recognized for only those activities that the reporting entity performs.

Mr. Foster, while not opposed to View B, preferred View C, a “value added” view. He believes that View C would result in improved comparability between industries and would result in recognizing revenue that is most representative of the economic activity that took place.

Mr. Trott supported view B because he believes that the gross contract price provides valuable information regarding the measurement of the liability. He noted that an entity’s contractual obligation to its customer remains, even if the performance of that obligation is fulfilled by a third party (unless it is assumed by that third party).

Mr. Schieneman observed that he views revenue as a measure of activity and believes that the focus of this discussion should be on the quantity of sales (and the related measurement of that quantity.) He believes that View B is a better approach for certain industries, for example, those that do not subcontract regularly or do not subcontract significant amounts. For those that subcontract regularly, Mr. Schieneman would prefer View D.

Mr. Crooch expressed his support for View B. He added that additional display information should be considered to compensate from any information that is not available under this approach, such as, for activities that were subcontracted and not actually performed by the reporting entity.

Mr. Wulff stated that View D might not be operational for most companies. He proposed a modified View B that would address activities such as subcontracting.

Ms. Schipper observed that Views B and D are most consistent with the conceptual framework. She indicated that the difference between the two approaches relates to extinguishment of a liability. When an obligation is performed by a third party, but is not legally assumed by that third party, different amounts of revenue would be recognized under Views B and D. Another point to consider in choosing between the two alternatives is whether or not outsourcing is an economically different event that is worthy of recognition. In addition, View D has more measurement and analysis complexity than View B. However, view B entails a loss of information as compared to View D. She added that she believes that the pros and cons of each approach, while different, are essentially a “wash.” Ms. Schipper noted that a compromise between Views B and D would be the application of View B with additional display.

Mr. Herz also expressed his support for View B, citing it as a better starting point for the definition of revenue as its basis is one of the fundamental elements of financial statements. He noted it does not solve all the subsequent problems including defining liability extinguishment.

The Board asked the staff to provide a comprehensive comparison of Views B and D for the next Board meeting. In addition, the staff should consider how added display might be used to supplement to View B.

Follow-up Items:
None

General Announcements:
None