MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Revenue Recognition Team (B. Wilson, ext. 275)
Subject:	Minutes of the October 9, 2002 FASB Board meeting
Date:	October 15, 2002
Code:	A: RR
cc:	Leisenring, Bielstein, T. Johnson, Smith, Petrone, MacDonald, Mahoney, Swift, Polley, Thompson, Gabriele, Sutay, Patton (GASB), Slayton, Such, Manders, B. Wilson, Cohen, Lapolla, Intranet

Topic:	Revenue Recognition ─ Conceptual Criteria that Underlies Revenue Recognition
Basis for Discussion:	Memorandums dated September 27, 2002 and October 8, 2002
Length of Discussion:	9:00 a.m. to 10:00 a.m.

Attendance:

Board members present:	FASB: Herz, Crooch, Foster, Trott, Schieneman, Schipper, and Wulff IASB: Leisenring
Board members absent:	None
Staff in charge of topic:	T. Johnson, Slayton
Other staff at Board table:	Bielstein, Such, Manders, B. Wilson
Outside participants:	IASB: J. Paul (by phone)

MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION

The Board began considering conceptual criteria underlying revenue recognition. The meeting focused on developing criteria that are based on changes in assets and liabilities and are consistent with the definitions of assets and liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*. The Board approved the staff's preliminary set of working criteria, termed the *element* criterion and *measurement* criterion, for use in discussions of case examples at subsequent Board meetings. The Board also reconfirmed its support for the approach to revenue recognition that focuses on changes in assets and liabilities.

DISCUSSION

Mr. Johnson began the discussion by highlighting some of the problems associated with the existing conceptual guidance. The existing criteria for revenue recognition, which recognize revenues that have been realized or are realizable and earned, can conflict with the definitions of assets and liabilities defined in Concepts Statement 6. As a result, applying the existing criteria can result in the deferral of revenues that are recorded as liabilities even though they do not meet the definition of liabilities.

Mr. Johnson stated that the staff believes that the preliminary set of working criteria proposed is consistent with an approach to revenue recognition that focuses on changes in assets and liabilities. The staff emphasized a fundamental premise that underpins the proposed working criteria is that the criteria must be consistent with previously adopted concepts, except for those in FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises,* that pertain to components of earnings.

The Board discussed the working conceptual criteria developed by the staff to address those issues. Mr. Trott found the staff's approach to be reasonable and agreed with the preliminary working criteria. However, he felt that the elements criterion describing revenue as an increase in equity was too subtle. He also pointed out that executory contracts or other contracts that precede the delivery of product or performance of a service will be a key point that the staff should focus upon. Other Board members concurred with the existing working elements criterion as written.

Ms. Schipper pointed out that the measurement criterion contains many contentious issues, including a choice of relevant attributes, the meaning of sufficient reliability, and the application of fresh-start accounting. She suggested that the accounting for contractual rights and obligations might be guided by notions of contractually legal and separable, as they relate to intangible assets in FASB Statement No. 141, *Business Combinations*.

Mr. Wulff stated that he generally agrees with the staff's approach, but is concerned with eliminating a realization and earnings approach, and suggested to look for opportunities to incorporate parts of Concepts Statement 5 into Concepts Statement 6. Mr. Schieneman, who agrees in principle with the staff's approach, expressed reservations about its application. He expressed concerns about predictability in forecasting and asked the Board to consider the cost-benefits of such an approach. Mr. Crooch also stated that he supports the staff's approach, but anticipates future discussion on whether this approach eases solving revenue recognition issues and is representationally faithful. He does not believe the staff's approach is a panacea for solving all the revenue recognition problems.

Mr. Herz generally agreed with the staff's approach but expressed concern with the elimination of the relevance criterion. He expressed interest in having the staff catalogue recent revenue recognition issues to identify where relevance of the accounting information has played an important role. Mr. Leisenring noted that it would be difficult and perhaps impossible for the staff to accomplish such a task.

Ms. Schipper stated there is "superficial agreement" among Board members on the staff's approach. She cited the need for the Board to agree on several key issues, such as the definition of relevance and the definition of a complete transaction. She expressed the need for the Board to distinguish between predictability in the short-term and long-term, and noted that long-term predictability should be the goal. Mr. Schieneman disagreed, stating that long-term predictability is virtually impossible because of extraneous events and the fact that markets operate in the short-term. Ms. Schipper replied that research suggests long-term forecasting precision degenerates, but the markets operate for the long-term.

Dialogue between Board members came back to the discussion of the earnings process, with Mr. Wulff stating that Concepts Statement 5 was designed to capture the effects of transactions on the balance sheet. He stated that deferred revenues are unfulfilled obligations, but that they do not fit the existing definition of a liability. He suggested examining the earnings process with respect to liabilities and realization with respect to assets. Ms. Schipper interpreted that comment to mean that Mr. Wulff believes that the definition of a liability is not expansive enough.

Mr. Leisenring noted that having a relevance criterion may allow for recognizing things on the balance sheet that are not assets or liabilities. He added that the way that the percentage of completion method has evolved has strayed away from definitions of assets and liabilities. Several Board members cited the need to distinguish between subversive implementation of standards and defective standards. Ms. Schipper stated that preventing subversive implementation required that the standards be strictly applied.

Mr. Trott noted the desirability of establishing a point in time for assessing whether the staff's approach is proving productive, adding the he believed that it would be productive. Ms. Schipper suggested that the staff share with the Board the examples being developed for use at the AAA-FASB conference in December.

The meeting concluded with Mr. Herz's summary that the Board approved the staff's preliminary set of working criteria for use in discussions of case examples in subsequent Board meetings, and the Board also reconfirmed its support for the approach to revenue recognition that focuses on changes in assets and liabilities. No Board members objected.

OTHER TOPICS OF DISCUSSION

None

GENERAL ANNOUNCEMENTS

None

SUMMARY FOR ACTION ALERT

See MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION