MINUTES

To:	Board Members
From:	Mathys (ext. 446)
Subject:	July 16, 2008 Board Meeting Minutes: Revenue Recognition
Date:	July 28, 2008
cc:	FASB: Bielstein, Golden, Stoklosa, Proestakes, Posta, Lott, T. Johnson, Bement, Reager, Bonn, Zeyher, Zhu, Nickell, Yust, C. Smith, Glotzer, Mechanick, Gabriele, Chookaszian, Klimek, Allen, Sutay, Mathys, FASB Intranet; IASB: Leisenring, Rees, Pitman, Hickey, Upton, Clark, Peerless, Knubley; AASB: Paul; GASB: Patton, Reese

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Topic:	Revenue Recognition
Basis for Discussion:	Board Memorandums 112 and 113
Length of Discussion:	9:05 to 10:25 a.m.

Attendance:

Board members present:	FASB: Herz, Batavick, Linsmeier, Seidman, and Smith
Board members present:	IASB: Leisenring
Staff in charge of topic:	Wilks, Rees
Other staff at Board table:	Bement, Vessels, Golden, Bonn, Reager, and Mathys
Participating by phone:	Pitman
Outside participants:	None

Summary of Decisions Reached:

The Board discussed the plan for completing the revenue recognition project. The Board agreed that a discussion paper should be issued later this year with at least a four-month comment period. The Board also agreed that the revenue recognition project is a high priority and that the goal is to issue a general revenue recognition standard by June 2011.

The Board also discussed the potential scope of a general revenue recognition standard. However, no decision was made and the issue will be deliberated at a future Board meeting.

The Board agreed that at contract inception a bundle of identified performance obligations would be measured at the contract price, thus precluding revenue (or gain) recognition at contract inception. An entity would allocate the contract price to individual performance obligations based on its actual (or estimated) selling prices for the promised goods and services.

Finally, the Board affirmed its May 2008 decision that performance obligations should be remeasured only if they are deemed onerous. The Board rejected the possibility of remeasuring performance obligations because they have regularly observable exit prices or because they span multiple accounting periods and are highly uncertain.

Objective of Meeting:

The objectives of this meeting were to:

a. Seek the Board's approval of the staff's plan and timetable for completing the revenue recognition project.

b. Ask the Board to approve the description of how to measure performance obligations and the different reasons for adopting that approach.

c. Ask the Board whether it agrees that performance obligations should be remeasured only when they are deemed to be onerous.

The objectives were met.

Matters Discussed and Decisions Reached:

- Issue 1: Discussion Paper and Corresponding Comment Period (Paragraphs 1–12)
- Issue 2: June 2011 Deadline (Paragarphs 13 and 14)
- Issue 3: Scope (Paragraphs 15–23)
- Issue 4: Measurement (Paragraphs 24–31)
- Issue 5: Cost Recognition (Paragraphs 32 and 33)

ISSUE 1: DISCUSSION PAPER AND CORRESPONDING COMMENT PERIOD

1. Mr. Rees began the discussion on completing the revenue recognition project by stating that one of the objectives of the discussion was to agree to the issuance of a discussion paper in the next few months.

2. Mr. Rees stated that the discussion paper would describe a single contract-based revenue recognition principle, which is consistent with current literature and practice in some cases but may pose a major change in other cases (specifically noting construction contracts under AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts,* and IAS 11, *Construction Contracts*). He said that although certain aspects of the customer consideration allocation approach to measuring performance obligations are familiar to current practice, allowing estimates of standalone selling prices for purposes of determining the unit of account is a significant change to U.S. practice.

3. Mr. Rees recommended issuing a discussion paper later this year with a four-month comment period. He noted that constituents' input on the proposed revenue recognition principle would be useful at this stage of the project. The Board agreed to issue a discussion paper with a minimum four-month comment period.

Issue 1 Board Comments

4. Mr. Smith stated that he would not object to the issuance of a discussion paper, but he does not believe one is necessary. Mr. Smith also voiced concerns about the timing of the issuance of an Exposure Draft because the proposed issuance date does not seem to realistically allow comments received on the Discussion Paper to be faithfully reflected in the Exposure Draft.

5. Ms. Seidman stated that she thinks it is necessary to issue a discussion paper because the standard on revenue recognition affects every company in the world, and it is important to follow due process and engage people's comments before a new revenue recognition model is set.

6. Mr. Batavick agreed with Ms. Seidman and encouraged the staff to go forward with a discussion paper. He noted that constituents' input will be important because the project is unique in that the proposed discussion paper will address the overall conceptual approach that the Board would like to take. However, Mr. Batavick voiced some concern at the list of "open issues," and noted that a discussion paper would normally address more of those issues. Mr. Batavick was also encouraged that the staff will be talking with constituents throughout the comment period because it is important to proactively reach out to constituents who might not otherwise provide as much input at this stage of the project. Mr. Batavick also commented that he would prefer a comment period longer than four months.

7. Mr. Linsmeier also agreed with Ms. Seidman and Mr. Batavick. He believes that the proposed model is a drastic change to the current model in some respects, and noted that the United States. is used to many pieces of guidance specific to industries, transactions, and revenue cycles, so the Board needs a reaction as to how a general standard might work and what issues may arise. Mr. Linsmeier also agreed with Mr. Smith's concern that by working on the Exposure Draft immediately, constituents may get an impression that their comments are not being properly considered. Overall, however, Mr. Linsmeier is comfortable with issuing the Exposure Draft and the four-month comment period.

8. Mr. Leisenring commented that he does not believe the IASB will agree to a four-month comment period because, historically, the IASB favors longer periods, such as six or nine months. Mr. Rees acknowledged the possibility that the IASB may ask for a six-month comment period. However, Mr. Rees clarified that the nature of this discussion paper is more targeted than other discussion papers with its focus on whether a single revenue recognition model is acceptable to constituents on a high level.

9. Mr. Smith voiced concerns about receiving comment letters at the end of the comment period that severely disagree with the proposed model, thus compromising the proposed timeline to issue a standard.

10. Mr. Rees clarified that the overarching purposes of the discussion paper are to explain to the public that the proposal is for a single revenue recognition principle that will apply in contractual settings and to show the public how the proposed model relates to current revenue recognition practices. It is also meant to educate constituents in terms of the Board's decisions to date and to note where fundamental changes may be made.

11. Mr. Linsmeier requested that the discussion paper clarify that although the Board will continue deliberations while the discussion paper is out for comment, the Board is not precluding addressing comments. Rather, the Board would use that time to begin drafting the language of the Exposure Draft and address issues not included in the discussion paper.

12. Mr. Golden assured the Board that if any major objections to the proposed model were voiced in the comment letters, the staff would bring those letters to the the Board's atttention. Additionally, Mr. Wilks explained that the topics for deliberation are ordered in a way that the Board would not be deliberating issues that were included in the discussion paper for comment.

ISSUE 2: JUNE 2011 DEALINE

13. The staff proposed setting June 2011 as a deadline (rather than a goal) for completing the project. The Board agreed that the revenue recognition project is a high priority, and that the goal is to issue a general revenue recognition standard by June 2011. However, the Board was reluctant to call the date a deadline because that might suggest compromising the quality of a standard to achieve the deadline, which it is not willing to do.

Issue 2 Board Comments

14. Mr. Linsmeier voiced concerns about having an "absolute deadline" because the staff and the Board do not know what issues will surface in the public comment period. Mr. Linsmeier believes that the revenue recognition project should be a "priority," but does not agree that stating June 2011 as an absolute deadline is consistent with being open to public commentary. Mr. Herz agreed that the revenue recognition project should be a high priority for the Board, but that June 2011 should not be a firm deadline if achieving that deadline would mean compromising the quality of the standard.

ISSUE 3: SCOPE

Issue 3 Board Comments

15. Mr. Linsmeier expressed surprise at the conclusion in paragraph 17 of Memo #112, which states that the Boards have already concluded that "the scope of the general revenue recognition standard is revenues arising in *contractual* settings." He voiced concern that the implication is that noncontractual revenue settings will not be considered. Mr. Linsmeier stated that he thought the agreement was to develop a revenue recognition model for contracts and then see if the general standard could be extended outside the contract arena to noncontract circumstances.

16. Ms. Seidman stated that she is comfortable that the purpose of **this** project is to establish accounting for revenue recognition for *contracts* with customers. She believes it was voted on many times, and that it is clearly described in previous memos.

17. Mr. Leisenring agreed with Mr. Linsmeier, and stated that he thinks no agreement was ever made regarding what constitutes a contract. He cited the Board's previous debate about delivery of paint without a contract.

18. Mr. Golden asked if Mr. Linsmeier believes that noncontracts should be in the scope of the project. Mr. Golden noted the aggressive nature of the timeline, so an agreement on scope should be made as soon as possible. Mr. Linsmeier responded that he does not have a problem with the issuance of the discussion paper on the contract-based approach, but he does want to explore the possibility that the approach may be applicable more broadly.

19. Mr. Herz agreed with Ms. Seidman that the scope is contracts with *customers.* He said that he believes financial instruments should not be within the scope because they deal with *counterparties.* Mr. Linsmeier asked if the Board has a common understanding of what a *customer* is, and whether or not *counterparties* are customers.

20. Mr. Wilks stated that he thinks most readers will fly past the term *customer,* thinking that they have a general idea of what that word means. Mr. Wilks then stated that a previous memo defines *customer* as an entity that represents counterparty in a contract that is to receive promised economic resources. Mr. Linsmeier and Mr. Leisenring stated that it must be clear what a customer is so that the Board does not receive letters from constituents who are not clear whether or not the standard applies to their circumstances. Mr. Herz and Ms. Seidman stated that they believe the discussion paper should simply exclude financial instruments from the scope, and, therefore, the definition of *customer* would not be an issue.

21. Mr. Herz stated that the fundamental issue is whether or not the Board should pursue the proposed model for revenue recognition, a financial instruement model, or a hybrid of both models. Mr. Leisenring agreed and stated that he would like the scope to be clear so that the assumption is known. Mr. Golden asked Mr. Linsmeier whether or not he believes that financial instruments should be included in the scope of the discussion paper. Mr. Linsmeier responded in the affirmative, citing that the reason for View B of Memo #112 is to encompass financial instruments.

22. Mr. Leisenring observed that Question 8 of Memo #113 is unclear and he had inferred that commodities and financial instruments are, in fact, included in the scope of this project. Mr. Golden clarified that if an aluminum producer has a contract to sell to General Motors, then aluminum, as a commodity, is in the scope. However, if the company is going to buy and sell aluminum because the company is a *dealer* in aluminum, it is not included in the scope.

23. Mr. Wilks recommended that the discussion paper explain that the model is meant to be broadly applicable, and that the Board should invite comments for whether a single revenue recognition model would be appropriate for particular industries. Therefore, constituents will voice concern if financial instruments are problematic under the proposed model, which will help the Board decide on the scope of the Exposure Draft.

ISSUE 4: MEASUREMENT

24. Mr. Wilks stated that the staff believes an observable current exit price is very rare, and that it usually applies only to financial instruments and commodities, which may be scoped out of this project. Even if they were in the scope of the project, they would likely result in similar treatment as other promised goods and services. Therefore, the staff recommended remeasurement only when a performance obligation is judged onerous.

25. The Board affirmed the decision from the May 2008 meeting to only remeasure when a performance obligation is deemed onerous. The Board requested that the process for determining when a performance obligation is *onerous* remain open for discussion.

Issue 4 Board Comments

26. Mr. Linsmeier noted some concern, in response to Question 2, that paragraph 9 of Memo #113 is incomplete regarding View B. He stated that his reaction as a proponent of View B is that View B was not comprehensively articulated, and that paragraph 11 should be included in the description of View B.

27. Mr. Leisenring stated that there are people who would not want to recognize revenue at contract inception, but who also would not want to preclude themselves from recognizing a gain at contract inception if a regularly observable price is available.

28. Mr. Golden clarified that the scope of this project does not include financial instruments, stating that it would be difficult to find an example where there is a gain at an observable price that is not related to financial instrument or commodities. Ms. Seidman agreed.

29. Mr. Herz asked whether or not there are circumstances under the scope of this project in which one would recognize a gain. Mr. Herz and Ms. Seidman agreed there are so few instances that it should not be written into the standard.

30. Mr. Wilks asked the Board if it agrees that the existence of an observable current exit price for a performance obligation after contract inception is not sufficient cause to remeasure performance obligations. Ms. Seidman clarified that Mr. Wilks' question was for a "**regularly** observable current exit price." Mr. Wilks agreed.

Board Vote

31. The Board voted against allowing any exceptions to the allocation approach even if there is a regularly observable Level 1 exit price. All Board members agreed.

ISSUE 5: COST RECOGNITION

Issue 5 Board Comments

32. Mr. Herz noted that much of U.S. literature on revenue recognition has industry-specific types of guidance. This guidance deals not only with the revenue side of the transaction, but also the associated costs. Mr. Herz stated that his understanding is that it is the assumption of this proposal that, other than inventory, there will not be deferred costs or acceleration of revenue to match costs spent (upfront costs). In other words, costs will be expensed as incurred. Mr. Herz noted two points:

    a. This needs to be clear because people will ask about the associated costs.

    b. This represents a major change in reporting, and the Board's audience will think of reporting and accounting the same.

Mr. Wilks and Mr. Reese responded that the discussion paper will make it clear that revenue is recognized when you satisfy performance obligations.

33. Mr. Leisenring also expressed concern about recognizing costs. Mr. Leisenring stated that he is concerned about whether one can defer something that may or may not be an asset. He mentioned deferred policy acquisition costs as an example in the insurance industry. Mr. Wilks explained that deferred acquisition costs may be a “mislabeled” asset, and that the new model will not allow them to be called an asset, either as an intangible asset or as a contract with a customer. Mr. Herz also stated that unless it qualifies as inventory, every other cost is expensed as incurred, but the approach to inventory accounting will not change. However, the proposal would dramatically change deferred costs from current practice, and it also would change the practice of accelerating portions of revenue to match up-front costs.

<u>Follow-up Items:</u>
None

<u>General Announcements:</u>

None