MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Revenue Recognition Team (B. Wilson, ext. 275)
Subject:	Minutes of the November 13, 2002 FASB Board meeting
Date:	November 19, 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 — Applying the Working Criteria to Cases from EITF Issue No. 00-21
Basis for Discussion:	Memorandums dated November 1, 2002
Length of Discussion:	9:30 a.m. to 10:10 a.m.

Attendance:

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

MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION

The Board discussed the results of applying the assets and liabilities approach to a collection of specific cases from EITF Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." The Board considered the similarities and differences in the results produced by that approach and the EITF's approach. The Board expressed approval for moving forward with the assets and liabilities approach, including measuring the liabilities incurred at their fair value to the reporting entity, and noted the need to consider reliability issues associated with those measures, as well as measures at subsequent dates. The Board generally agreed that the fair value of performance obligations should reflect the price that the reporting entity would have to pay a third party to assume responsibility for performing those obligations. The Board further agreed that the effects of a reporting entity's obligations with respect to refund rights should be reflected in the measurement of its liability for its performance obligations to the customer.

DISCUSSION

Mr. Johnson began the discussion by noting that applying the assets and liabilities approach to specific cases helps demonstrate how that approach can resolve complex revenue recognition problems. The cases in EITF Issue 00-21 are appropriate to consider because they illustrate areas where there is diversity in practice and the EITF has had difficulty in resolving the issues. The staff described how the assets and liabilities approach resulted in answers similar to or different from those produced using an earnings process approach. In those cases, the assets and liabilities approach focuses on identifying the assets obtained and liabilities incurred in the arrangement, and measuring them at their fair values; in contrast, the earnings process approach focuses on identifying separate earnings processes and basing the measurement of the related revenues on relative fair values and allocation techniques.

Mr. Foster stated that he fully agrees with the staff's recommendation and proposed future directions in the project.

Mr. Trott stated that he was very encouraged by the staff's analyses and supportive of its recommendations. He also expressed the need to address reliable measurement and subsequent accounting earlier in the project. He and other Board members noted the measurement challenges that the assets and liabilities approach will need to consider. He also noted that there may be instances where it might be appropriate to use entity-specific measures.

Mr. Foster referred to the memorandum he wrote on entity-specific measures that was just distributed that morning. He noted that there may be instances where information specific to the entity might have to be used to approximate fair values. Mr. Crooch asked whether he interpreted the third level of the measurement hierarchy as a practical expedient. Mr. Foster responded that the hierarchy is supposed to comport with FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements,* and is an expedient.

Ms. Schipper stated that she concurs with all of the staff's recommendations. She noted that other projects, such as the Purchase Method Procedures project, are predicated on fair value measurement rather than accounting by allocation, and that moving away from measurement would be a step backwards. She noted that a troublesome question is whether fair values are to be measured in a market in which the customer transacts or a market in which the reporting entity transacts, and agreed with the staff's recommendation that fair values should be measured in the most favorable markets to which the reporting entity has access. Ms. Schipper also agreed with Mr. Trott on the need for fair value measurement guidance and asked the staff to consider how to measure an asset or liability when a fair value is not available in the marketplace.

Mr. Wulff stated that he concurs with the staff's analyses and agrees that the assets and liabilities approach is conceptually superior to an earnings process approach. He has concerns, however, with the linkage of fair value measurement and materiality. Mr. Wulff strongly encourages the staff and Board to address quickly two measurement issues, defining sufficient reliability as it relates to fair value and what to do it when fair value is not determinable. He is also concerned with subsequent accounting and is uncomfortable with the notion of recognizing revenue on the selling activity without delivery or other performance occurring.

Mr. Schieneman indicated that he agrees with the staff's approach more reluctantly than Mr. Wulff. He expressed the need to consider whether this approach is more useful to users and preparers rather than just conceptually sound. He asserted that measurement is still an allocation process and he does not believe the "wholesale" market price is the most relevant measure. He also concurs with Mr. Wulff in his discomfort with recognizing revenue at the signing of a contract, before delivery of a good, or performance of service.

Mr. Crooch stated that he agrees with the staff's approach and believes that it will lead to a better answer. He noted that that concept that underpins revenue recognition in this approach is inherent in the Business Combinations project. He added that measurement issues will be tough.

In response to Mr. Schieneman, Mr. Trott stated that problems in revenue recognition arise because there is lack of conceptual guidance. He further stated the upfront recognition of revenue is necessary because an asset (a customer relationship) is obtained at contract signing and it eliminates the deferral of revenue. Ms. Schipper expanded on Mr. Trott's comments, noting that, in her belief, the current literature is biased towards delayed revenue recognition, and that the asset and liability approach is more neutral and representationally faithful. She also stated that the current literature is rigid, biased towards conservatism, and inflexible.

Mr. Herz stated that the assets and liabilities approach is vastly superior to the traditional accounting approach to carving up amounts. He asked the staff to further consider whether a market driven fair value is a better measure than an entity-specific measure, and what to do if reliable measures are not available. The staff agreed to explore this issue further.

Summing up, Mr. Herz stated that Board members are encouraged by what the staff's analyses demonstrated regarding the use of the asset and liabilities approach to resolve complex revenue recognition problems like those in EITF Issue 00-21. He added that no Board members reject the approach, and noted that the staff should address concerns about measurement as soon as feasible.

OTHER TOPICS OF DISCUSSION

None

GENERAL ANNOUNCEMENTS

None

SUMMARY FOR ACTION ALERT

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