

MINUTES



Financial Accounting  
Standards Board

**To:** Board Members  
**From:** Revenue Recognition Team  
(Murphy, ext. 208)  
**Subject:** Minutes of the May 11, 2005 FASB Board Meeting **Date:** May 17, 2005

**cc:** FASB: Bielstein, Smith, Petrone, T. Johnson, Tovey, Thuener, Figgie, Kawanishi, Murphy, Kapko, MacDonald, Proestakes, Mahoney, Golden, Cropsey, Lapolla, McKenna, Polley, Getz, Gabriele, Sutay, Intranet; GASB: Patton; IASB: Leisenring, Paul, Crook, Brown

*The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.*

Topic: Revenue Recognition: Project Objective

Basis for Discussion: Memorandum No. 68

Length of Discussion: 10:25 to 11:20 a.m.

Attendance:

Board members present: FASB: Herz, Batavick, Crooch, Schipper, Seidman, Trott, Young

IASB: Leisenring

Board members absent: None

Staff in charge of topic: Tovey

Other staff at Board table: Bielstein, T. Johnson, Figgie, Murphy

Outside participants: None

### Summary of Decisions Reached:

The Board discussed whether the objective and scope of the revenue recognition project should be changed and, if so, how. The Board affirmed its past decision to develop a standard for revenue recognition based on recognized changes in assets and liabilities (consistent with the definition of revenues in FASB Concepts Statement No. 6, *Elements of Financial Statements*) that would not be overridden by additional recognition criteria such as realization and the completion of an earnings process (as described in FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*). The Board expects that the “realized or realizable” and “earned” criteria in Concepts Statement 5 will be eliminated and the definition of revenues in Concepts Statement 6 will be refined to more clearly distinguish revenues from gains.

The Board also affirmed that its goal is to develop a comprehensive standard on revenue recognition that would apply broadly to all revenue arrangements. In connection with that decision, the Board agreed to pursue an approach under which performance obligations would be measured by allocating the customer consideration rather than at the fair value of the obligation (that is, the amount the reporting entity would be required to pay to transfer the performance obligation to a willing third party of comparable credit standing).

### Objective of Meeting:

The objective of the meeting was for the Board to discuss and decide whether the objective and scope of the Revenue Recognition project should be changed and, if so, how. The objective of the meeting was met.

### Matters Discussed and Decisions Reached:

1. Mr. Tovey introduced the topic and stated that while “getting up to speed” as the new project manager on the revenue recognition project, he concluded that the Board should revisit the project’s objective. That conclusion led to the issuance of Memo No. 68, which contains several alternative courses of action for the revenue recognition project. Mr. Tovey stated that the main

objective for the Board meeting is to decide on one or more of the alternatives outlined in Memo 68. (Those alternatives were included in the Board meeting audience handout, which is attached as an appendix to these minutes.) He asked Board members to express their preferences with respect to the alternatives presented in the memo.

2. Mr. Young stated that he supports Alternative 7, a staff-authored research report, which explores the asset-and-liability approach. He questioned whether there is a clear mandate from constituents to devote Board and staff resources to pursue a new revenue recognition standard. Specifically, Mr. Young noted that he would want a stronger “buy-in” from the user (analyst) community before undertaking a project that results in a new revenue recognition model. He stated that Alternative 7 would allow the staff to explore the proposed asset-and-liability approach and would allow the Board to determine if that approach more effectively addresses the existing problems and concerns related to revenue recognition.
  
3. Ms. Seidman stated that she strongly supports continuing to work on the revenue recognition project. She noted that existing guidance is not manageable and that international convergence on the topic of revenue recognition is critical. Ms. Seidman stated that a modified version of Alternative 2 best represents her view. Ms. Seidman stated that she supports a model that initially measures and records a transaction with a customer as a “basket” transaction. That is, the unit of account would be the transaction as a whole. The appropriate measurement attribute on “Day 1” would be fair value, which presumptively would be the total price paid by the customer (that is, the customer consideration amount). Ms. Seidman added that individual performance obligations should be measured based on an allocated customer consideration amount; however, she was not ready to opine on which allocation method should be used. She clarified that specifying an allocation basis should be a standards-level decision, not a concepts-level decision.

Ms. Seidman added that she would accept fair value as the most relevant measurement attribute for a performance obligation at the concepts level when an active market exists for the obligation being measured.

4. Ms. Seidman noted that Alternative 1 and Alternative 2 address subsequent measurement differently and added that she would prefer to not yet address subsequent measurement at the concepts level. Standards-level guidance on subsequent measurement could be established on a case-by-case basis based on factors such as a cost-benefit analysis. Ms. Seidman indicated that her second preference is Alternative 4, which would fill the voids in existing revenue recognition guidance and provide for a broad-scope codification. She also noted that some degree of simplification and codification work should be done regardless of which alternative is chosen by the Board.
5. Mr. Crooch stated that his preference is Alternative 1; however, he does not believe that a majority of Board members support Alternative 1. Therefore, as a compromise, he supports Alternative 2. He said that Alternative 2 has many (if not most) of the challenges that exist in Alternative 1 because the two alternatives are similar. For example, he noted that allocating the customer consideration amount would not be easier than obtaining or developing fair value measures. Nonetheless, he stated that a key benefit of Alternative 2 is that it does not recognize revenue upon contract generation (“selling” revenue); therefore, it is responsive to concerns about premature revenue recognition (frontloading).
6. Mr. Trott stated that at the concepts level his preference is Alternative 1; however, at the standards level, he prefers Alternative 2. He acknowledged that constituents have concerns about Alternative 1, including “frontloading” revenue and subsequent remeasurement of performance obligations. He noted that some constituents may perceive subsequent remeasurement as a mechanism to correct accounting errors. He added that the revenue

recognition team should work with the performance reporting team to address issues related to display and disclosures. Mr. Trott also stated that he would not support any of the other alternatives.

7. Ms. Schipper stated that she continues to support Alternative 1 because it is the most conceptually grounded approach. However, Ms. Schipper indicated that she will compromise and support Alternative 2. Ms. Schipper noted that Alternative 2 is explainable to constituents because it is similar to recently issued revenue recognition guidance, such as EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." She observed that both Alternative 2 and Issue 00-21 are based on the customer's perspective of the transaction. She also posited that the effect of Alternative 2 on current revenue recognition practices would depend on which piece of guidance a reporting entity is currently applying. Ms. Schipper noted that Alternative 2 is an effective compromise because it alleviates some of the difficulty associated with Alternative 1 related to the misidentification and the mismeasurement of performance obligations. That is because Alternative 2 requires that a reporting entity identify elements based on whether those elements have value to the customer. Moreover, the reporting entity would measure those elements based on an allocation of the customer consideration amount.
  
8. Ms. Schipper noted two areas in which Board members disagreed. Both relate to the following statement: "At the inception of the arrangement, the transaction amount is presumptively the fair value of the arrangement taken as a whole." She noted that Board members disagree on the notion of *the inception of an arrangement*. That is because some Board members believe that the inception of an arrangement could precede the signing of a contract; therefore, it is possible that the reporting entity performs revenue-generating activities before the contract is signed. Other Board members believe that the inception of the arrangement does not occur until the contract with a customer

is signed. As a result of that difference in perspective, she explained that Board members disagree on the notion of *the arrangement taken as a whole*. She concluded that if Board members have differing views on the arrangement's inception, it follows that Board members would have differing views on what constitutes the whole arrangement. Given those fundamental differences in views, Ms. Schipper noted that Alternative 2 seems to be a practical compromise.

9. Mr. Batavick stated that the Board would be remiss if it did not address revenue recognition. He supports Alternative 2. Moreover, he stated that Alternative 2 is an evolutionary (rather than revolutionary) approach to change and is understandable from a constituent viewpoint. Mr. Batavick stated that he might support Alternative 4 as a second choice. However, before fully supporting that alternative, he would want the staff to identify all the voids in current GAAP and have the Board decide on a case-by-case basis which voids should be addressed.
  
10. Mr. Batavick expressed certain concerns about whether Alternative 2 would be acceptable to the IASB. Mr. Leisenring responded that the majority of IASB Board members have indicated support for Alternative 1. He stated that the IASB Board has not discussed Alternative 2; however, IASB Board members may support that alternative at the standards level. He observed that Alternative 2 is different from Alternative 1 and that it is not far removed from existing revenue recognition guidance.
  
11. Mr. Herz stated that the Board has a responsibility to improve existing revenue recognition guidance. He stated that he supports Alternative 2. However, he noted that when an active market exists for the performance obligation being measured, fair value is the most relevant and reliable measurement attribute. He stated further that he would support exploring the possibility of using fair value (rather than an allocation of the customer

consideration amount) in those cases. But in cases in which active markets do not exist, Mr. Herz stated that he supports using an allocated consideration amount. He added that the conceptual framework project—not the revenue recognition project—should fully explore the relevance and reliability of alternative measurement attributes.

12. Ms. Bielstein clarified the interaction between the conceptual decisions made in the revenue recognition project and the conceptual framework project. She noted that the revenue recognition project was added to the Board’s technical agenda before the conceptual framework project. Therefore, at that time, the conceptual issues related to revenue recognition were expected to be addressed in the revenue recognition project. However, with the addition of the conceptual framework project, presumably the conceptual issues (for example, recognition and derecognition principles as well as measurement attribute guidance) would be more fully addressed in that project instead of in the revenue recognition project.

13. Mr. Johnson added that it is important to consider the conceptual rationale behind the standards-level decisions that the Board makes in the revenue recognition project. That rationale will have to be clearly communicated in the basis for conclusions of the standard on revenue recognition.

14. Mr. Tovey summarized the Board’s tentative decision. He stated that the majority of Board members (all but DMY) supports Alternative 2, either as a first (RHH, LFS, GJB) or second preference (EWT, GMC, KAS). Mr. Tovey noted that under Alternative 2, the “realized or realizable” and “earned” criteria in Concepts Statement 5 would be eliminated and the definition of revenues in Concepts Statement 6 would be refined to more clearly distinguish revenues from gains. Ms. Bielstein added that the Board’s decision would be discussed with the IASB Board.

Follow-up Items:

15. The FASB and IASB staffs will prepare a memorandum for IASB Board members that summarizes the FASB Board's discussion and tentative decision on the direction of the revenue recognition project.

General Announcements:

16. None.



## APPENDIX

### Board Meeting Handout May 11, 2005

#### Revenue Recognition

At today's meeting, the Board will discuss whether the objective and scope of the Revenue Recognition Project should be changed and, if so, how. As part of its discussion, the Board will consider 10 alternatives, or a combination thereof, as potential courses of action. Those alternatives are as follows:

#### **Alternative 1—Revenue Recognition Standard (asset-and-liability fair value approach)**

This is the revenue recognition model that the Board has considered since the project's inception. It would be based on the elements and measurement criteria developed to date, including the requirement that assets and liabilities are measured at fair value.

#### **Alternative 2—Revenue Recognition Standard (asset-and-liability performance value approach)**

This standard would be based on the elements and measurement criteria developed to date under Alternative 1, except the requirement that assets and liabilities are measured at fair value. Rather, assets and liabilities would be measured at their performance value: the price at which an asset or liability could be exchanged with a customer in a current transaction between knowledgeable, unrelated willing parties.

#### **Alternative 3—Revenue Recognition Standard (realized-and-earned approach)**

This standard would be based on the realized and earned criteria in FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*. It would use existing guidance (such as SEC Staff Accounting Bulletin No. 104, *Revenue Recognition in Financial*

*Statements*; EITF Issue No. 00-21, “Revenue Arrangements with Multiple Deliverables;” and FASB Statement No. 48, *Revenue Recognition When Right of Return Exists*) to build a realized-and-earned revenue recognition framework. That framework would be strengthened by filling voids and resolving some conflicts that currently exist in U.S. GAAP.

#### **Alternative 4—Filling Voids and Broad-Scope Codification**

This alternative is a two-pronged approach that aims to fill voids and resolve some conflicts in existing U.S. GAAP. The broad-scope codification would resolve conflicts between guidance for similar economic transactions or phenomena. This alternative would not result in a comprehensive standard on revenue recognition.

#### **Alternative 5—Narrow-Scope Codification**

A narrow-scope codification project would codify existing revenue recognition guidance and would only resolve conflicts when that guidance provides two or more methods of accounting for the same economic transaction. This alternative would not result in a comprehensive standard on revenue recognition.

#### **Alternative 6—Revenue Disclosures**

This alternative’s objective would be the improvement of revenue disclosures. This alternative would include an evaluation of revenue disclosures currently required and an analysis of how those disclosures could be improved to provide additional information on revenue recognition policies and revenue amounts recognized in the financial statements.

#### **Alternative 7—Research Report**

The Research Report is a staff-authored “white paper” that fully articulates the asset-and-liability fair value approach and applies it to representative revenue transactions. This report also could compare and contrast that approach with the current realized-and-earned model.

#### **Alternative 8—IASB-Led Project**

Under this alternative, the IASB Board would continue deliberating the asset-and liability fair value approach. The FASB Board would discontinue deliberations of revenue recognition issues until the IASB Board issues a Discussion Paper or Preliminary Views.

**Alternative 9—Deactivate**

The Board deactivates the Revenue Recognition Project but does not remove it from its agenda pending the performance of work in the Conceptual Framework and Liability Extinguishment projects.

**Alternative 10—Remove from Agenda**

The Board removes the Revenue Recognition Project from its agenda.