MINUTES

Financial Accounting Standards Board

To:	FASB Board Members
From:	Revenue Recognition Team (Stoviak x471)
Subject:	November 4, 2010 Roundtable Minutes: Revenue Recognition
Date:	December 22, 2010

<u>Topic</u>:	Proposed Accounting Standards Update: *Revenue Recognition (Topic 605): Revenue Recognition (Topic 605)*
<u>Length of Discussion</u>:	1:00 p.m. to 4:00 p.m.

<u>Attendance</u>:

Outside Participants

Paul Beswick	Securities and Exchange Commission
Michael Cleary	Boeing Company
Brett Cohen	PricewaterhouseCoopers, LLP
David Guy	State Street Corporation
Ken Heintz	Northrop Grumman Corporation
Tricia O'Malley	Canadian Accounting Standards Board
Amy Ripepi	Financial Reporting Advisors, LLC
Brooke Richards	American Express Company
Philip Rouse	Card Compliant, LLC
David Sheffield	EMS Technologies, Inc.
Bob Uhl	Deloitte and Touche

FASB & IASB Participants

Leslie Seidman	Prabhakar "PK" Kalavacherla
Russ Golden	FASB Acting Chairman
Tom Linsmeier	FASB Board Member
Marc Siegel	FASB Board Member
Larry Smith	FASB Board Member
Patrick Finnegan (via video)	FASB Board Member

IASB Board Member	Stephanie Stoviak
IASB Board Member	FASB Senior Advisor
Jim Leisenring	FASB Assistant Director
Peter Proestakes	FASB Project Manager
Kenny Bement	IASB Technical Principal
Henry Rees	FASB Practice Fellow
Prasadh Cadambi	IASB Senior Technical Manager
Glenn Brady (via video)	IASB Technical Manager
April Pitman (via video)	FASB Assistant Project Manager
Liz Gagnon	FASB Postgraduate Technical Assistant
Libby Biittner	FASB Postgraduate Technical Assistant

CONTROL

Transfer Model

1. Most participants broadly agreed with the principle of recognizing revenue based on when a good or service has been transferred to the customer rather than based on activities, but believe that additional indicators and implementation guidance are needed to depict the transfer of control for service contracts and more specifically long-term construction contracts. For service contracts, one participant noted that two of the four control indicators in the model do not pertain to the transfer of control for service contracts, such as *the customer has legal title* and *the customer has physical possession*. One participant also indicated that the *unconditional obligation to pay* indicator should not require the obligation to be *unconditional*. A few participants expressed concern about the auditability of the indicators and whether audit firms will require all or one indicator to be met in determining whether control has been transferred to the customer. Other participants agreed with the transfer model but recommended the Boards add additional implementation guidance to address service contracts, specifically on control of a partially completed asset for long-term construction contracts.

2. Some participants believe that the transfer model works well for the transfer of goods, but the transfer model does not work well for the transfer of services. Therefore, they recommended an activities-based model be used for the transfer of services. Those participants did not support the concept of *control* for service contracts because there is no

asset to *direct the use of or receive the benefit from* once the service has been provided. They believe that if a transfer model is retained, then transfer should be based on the *transfer of economic value* or *when the customer receives the benefit from the service.* Some participants recommended that the Boards create specific indicators to depict the transfer of control for service contracts because they believe the proposed control indicators are not all applicable to service contracts.

Customer versus Entity Perspective

3. A few participants noted that the Exposure Draft's proposed guidance to assess the timing of control transfer from the customer's perspective would be operational for transfer of goods. However, for service contracts, they believe that the entity perspective might best depict the underlying economics because that approach would result in the entity recognizing revenue when the entity satisfies its performance obligation. Additionally, they noted that in the case of goods, both perspectives would likely lead to the same result. Therefore, they recommended that the Boards consider whether the control should be applied from the entity's perspective.

IDENTIFYING SEPARATE PERFORMANCE OBLIGATIONS

Principle of Distinct

4. Participants generally supported the principle of distinct as the basis of identifying separate performance obligations but expressed concern about the operationality of the specific criteria in determining whether a good or service is *distinct.* Many participants did not support the proposed criteria to determine whether an entity should account for a good or service separately and recommended the determination be based on the customer's expectation regarding the good or service provided. One participant recommended that the Boards specify the broad principle of distinct accompanied by additional indicators rather than specific criteria. The participant also recommended the criterion of a *distinct offering by a vendor or a distinct purchasing decision by the customer* when determining whether a good or service is distinct. A participant representing a financial institution indicated that any service may be sold separately in a service organization, and a good or service should be identified as distinct based on the customer's expectation and not based on the

contractual nature of the arrangement. Some participants requested that a top-down approach be allowed for determining separate performance obligations so that the separation of inconsequential and perfunctory items is minimized. One participant recommended that the criterion *the entity, or another entity, sells an identical or similar good or service separately* be modified to require that the good or service be sold separately by the entity or other entities in the entity's principal market or a similar market. This modification would alleviate concerns about identifying performance obligations at levels that are not meaningful to financial statement users.

DETERMINING AND ALLOCATING THE TRANSACTION PRICE

Determining the Transaction Price

5. One participant supported the use of the probability-weighted estimate when an amount of consideration is variable and an entity has a large number of homogenous transactions. The participants generally did not support the use of the probability-weighted estimate when transactions have binary outcomes because the estimate may not represent the amount an entity actually expects to receive from a transaction. Some participants recommended that the Boards permit the use of management's best estimate as the basis for determining the transaction price to accommodate circumstances in which the probability-weighted estimate does not appropriately reflect the amount of consideration management expects to receive from a transaction. Other participants suggested that management's best estimate is more appropriate because it incorporates management's past experience with the customer and that approach can be implemented in a cost efficient manner. A few participants also recommended incorporating a threshold (for example, *more likely than not)* when determining the transaction price in situations with binary outcomes, such as performance bonuses that the vendor will either receive in full or not at all.

Time Value of Money and Collectibility

6. Many participants agreed that the transaction price should reflect the effects of the time value of money if the contract includes a material financing component. Some participants did not believe that the transaction price should reflect the time value of money because the calculation would be cumbersome and the cost would outweigh the benefit provided to financial statement users.

7. A majority of participants did not agree with the proposal to reflect the customer's credit risk in the initial measurement of revenue and to recognize subsequent changes in the assessment of credit risk as other income or expense. Some participants believe that financial statement users would gain more useful information if all of the effects of the customer's credit risk are reported outside revenue. Others agreed with the proposal to reflect the customer's credit risk in the initial measurement of revenue but believe that subsequent changes in the assessment of credit risk also should be recognized as adjustments to revenue.

OTHER ISSUES

Contract Costs

8. One participant recommended the Boards retain current guidance in regards to contract costs for areas, such as for federal contractors and for contract costs. The participant believes that if the cost guidance were to be retained in the proposal, then the guidance should be expanded to permit capitalization of deferred production costs, provide additional guidance on development costs, and provide further clarification in regards to abnormal contract costs.

9. Participants generally did not agree with recognizing an onerous liability for an individual performance obligation at inception of the contract when the overall contract is profitable. Those participants argued that it is not intuitive to incur a loss at contract inception, but rather a loss should be incurred after the contract's inception when the facts and circumstances of the contract have changed. Some participants recommended that the onerous test be performed at the contract level rather than for each individual performance

obligation. One participant indicated that a performance obligation might still be assessed as onerous despite performing the onerous test at the contract level if the benefit is derived from future contracts.

Gift Card Breakage

10. One participant encouraged the Boards to provide guidance regarding gift card breakage to permit an entity to derecognize the liability when gift card breakage occurs. The participant indicated that there are currently three methods available to derecognize the gift card liability, including the lump sum method, straight-line amortization method, and the statistical method. The participant noted that the statistical method is the preferable method because an entity would derecognize the liability using the same probability rate as the gift card redemptions, which best reflects the rate at which the gift card breakage occurs.

Customer Loyalty Programs

11. One participant encouraged the Boards to clarify that when combing two or more contracts, contracts should only be combined if they are with the same party. The participant indicated that the customer card contract is viewed separately from the merchant contract and, thus, these contracts are not interdependent.

Transition

12. Several participants did not agree that an entity should apply the proposed guidance retrospectively, especially for long-term contracts. Those participants believe that the costs of retrospective application would outweigh the benefits provided to financial statement users. Some participants also believe that if retrospective application were required, additional time would be needed to allow for entities to implement the proposal. Many participants encouraged the Boards to extend the timeline to allow for appropriate field testing to ensure that the final standard is operational. Several participants commended the Boards for their previous outreach efforts and encouraged the Boards to continue reaching out and testing the model to ensure that the final revenue recognition standard is operational and to minimize the risk of unintended consequences.