**MINUTES**

Financial Accounting Standards Board

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| **To:** | FASB Board Members |
| **From:** | Revenue Recognition Team (Biittner x462) |
| **Subject:** | November 23, 2010 Roundtable Minutes: Revenue Recognition |
| **Date:** | December 22, 2010 |

<u>Topic</u>: Proposed Accounting Standards Update: *Revenue Recognition (Topic 605): Revenue from Contracts with Customers*

<u>Length of Discussion</u>: 9:00 a.m. to 12:00 p.m.

<u>Attendance</u>:

*Outside Participants*

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| Carolyn Beaver | Beckman Coulter, Inc. |
| Prat Bhatt | Cisco Systems, Inc. |
| Reed Brimhall | URS Corporation |
| Karen Craig | NACUBO |
| Gordon Edwards | Legacy Health |
| Doug French | TELUS Corporation, Inc. |
| Jerry Henderson | Construction Financial Management Association |
| Jay Howell | BDO USA |
| Sujit Kankanwadi | Synopsys, Inc. |
| Elizabeth Karbo | Symantec Corporation |
| Bob Laux | Microsoft Corporation |
| Olivier Marie | eBay, Inc. |
| Kevin McBride | Intel Corporation |
| Mary Hartman Morris | California Public Employees' Retirement System |
| Elizabeth Mooney | Investors Technical Advisory Committee |
| Betsy Rafael | Apple, Inc. |
| Satish Rishi | Rambus, Inc. |
| Donald Robertson | SanDisk Corporation |
| Todd Schull | Sanmina-SCI Corporation |

*FASB & IASB Participants*

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| Russ Golden | FASB Board Member |
| Larry Smith | FASB Board Member |
| Prabhakar “PK” Kalavacherla | IASB Board Member |
| Kenny Bement | FASB Project Manager |
| Henry Rees | IASB Technical Principal |
| Prasadh Cadambi | FASB Practice Fellow |
| Libby Biittner | FASB Postgraduate Technical Assistant |

**CONTROL**

1. Many participants expressed concern about application of the proposed model to contracts for services due to the difficulty of determining when control of a service has been transferred. Additionally, they noted the high level of subjectivity when separating a services contract into performance obligations. This could potentially lead to diversity in practice.

2. A participant in the electronic manufacturing services industry stressed that because his company offers various types of services that can be combined in any number of ways, each contract is highly unique and the concept of transfer of control would be difficult to determine because customers “control” different components at different times. He suggested that in his contracts, delivery of the final product should be the point at which control is deemed to have transferred. He said that current practice in electronic manufacturing is to recognize revenue when the product ships, not as it is manufactured. Therefore, he would like the completed contract method to be retained.

3. Participants in the public accounting and software industries echoed the concerns about determining when transfer has occurred. They discussed the current shift toward “software as a service” transactions and the complexities of accounting for these transactions. They also noted that because the industry is changing so quickly, a new revenue recognition standard must be able to accommodate new types of transactions. T hey indicated that more robust examples and more control indicators would be helpful in determining when control has transferred.

4. A participant in the engineering and construction industry stated that continuous transfer is critical in his industry because the company provides a service and transfers control of the work in process on a daily basis.

5. A participant in the higher education industry highlighted the difficulty of measuring transfer of control when no specific good or service is produced or provided. For instance, contracts for the provision of research may last decades and not result in anything tangible, and it would be unclear in these cases when control has passed and revenue should be recognized.

6. A participant representing investors noted that there are concerns that the proposal would lead to recognition of revenue by companies before the transfer of risk. She noted that it would benefit investors if all estimates and assumptions related to revenue, including how separate performance obligations are identified, were disclosed.

7. A participant in the construction industry noted that there is a strong consensus among surety firms that the percentage of completion method needs to be retained because the financial information currently provided by application of that method is critical to their decision-making process. If that guidance is not retained, an alternative would be to distinguish between transfer of control of goods and services in the proposed model. When defining *transfer of control*, the Boards should include a rebuttable presumption that if an entity is doing work that is to the customer's specifications and involves unique approval of design plans, continuous transfer is occurring and further unbundling is not necessary. This would result in better accounting and reduce the opportunity for manipulation.

8. Several other participants expressed support for the development of separate models for accounting for goods and for services.

## IDENTIFYING SEPARATE PERFORMANCE OBLIGATIONS

9. A participant in the engineering and construction industry disagreed with the proposed guidance related to identifying separate performance obligations. He said that his interpretation of the guidance was that it generally would require contracts to be broken into multiple performance obligations and only rarely would allow a contract to remain as

one performance obligation. Participants in the software industry discussed the importance of developing guidance applicable to “software as a service” arrangements and agreed that the economics of a contract, not just performance obligations as defined in the proposal, should determine when revenue is recognized.

10. There was some discussion about which perspective should be used when identifying separate performance obligations because obligations such as shipping and installation would potentially be considered distinct from the vendor’s perspective but that may not be the case from the customer’s perspective.

11. Several participants were concerned that the description of distinct profit margin would in some cases inappropriately prevent the identification of separate deliverables.

12. A participant representing investors noted that she does not foresee any issues related to the identification of separate performance obligations from the user’s perspective.

**DETERMINING THE TRANSACTION PRICE**

13. Some participants did not agree with the use of a probability-weighted estimate of consideration expected to be received and questioned what it would actually represent and whether it would be a reliable measure of the transaction price. They believe that management’s best estimate would be a more practical and useful number. They remarked that it seems counterintuitive to recognize revenue at a consideration amount that is not a possible outcome of the transaction. Additionally, they noted that the probability-weighted estimate would likely be manipulated to match management’s best estimate.

14. A participant representing investors expressed concern that the use of so many estimates would result in abuse. She highlighted that especially in the software industry, investors do not perceive a problem with current guidance regarding transaction price (specifically, the use of vendor-specific objective evidence) and do not necessarily see the proposed guidance as an improvement.

15. Many participants, especially in the technology industry, argued that the cost of determining the probability-weighted estimate would be much greater than the benefit derived from it. They noted that it would take large amounts of resources to be able to achieve supportable calculations of probability-weighted estimate. Additionally, the probability-weighted estimate would continually need to be adjusted, which would be labor intensive and reduce the usefulness of the revenue number.

16. Some participants indicated that they would be uncomfortable recognizing any revenue related to uncertain consideration and that revenue should not be recognized until the revenue is certain.

### Time Value of Money

17. Some participants noted that the meaning of the term *material financing component* needs to be clarified.

## ALLOCATING THE TRANSACTION PRICE

18. A participant in the telecommunications industry indicated that the proposed allocation guidance would force his company to accelerate the recognition of billions of dollars of revenue, which would not represent the economics of the business and would be misleading to users of the financial statements.

19. Participants in the technology industry expressed support for the allocation model used in EITF Issue No. 08-1, “Revenue Arrangements with Multiple Deliverables” (which includes contingent cap) and believe that this allows the economics of transactions to be more accurately reflected than would the proposed model. They noted that it would be an improvement if all software and hardware arrangements were accounted for according to the same allocation principles and expressed a belief that entities should be able to use estimates of selling price as long as there is diligence in determining the estimates. Both telecommunications and software industry supported the contingent cap principle because it would not accelerate revenue recognition.

20. Several participants noted that they do not agree with the proposal that changes in transaction price should affect performance obligations that have already been fulfilled.

21. A participant stated that the notion of *reasonably estimable* needs to be more clearly defined.

**OTHER ISSUES**

**Warranties**

22. Some participants in the software industry noted that the warranty guidance is not operational due to the difficulty of differentiating between types of warranties. Specifically, it is difficult to determine whether a “bug fix” is a warranty to correct a latent defect or an insurance-type warranty. Participants questioned the value of distinguishing between the types of warranties and noted that the existing guidance on warranties is sufficient. Additionally, participants said that assessing warranties on a contract-by-contract basis would be onerous and that the assessment should be performed at the portfolio level.

**Licensing**

23. Many participants did not agree with the distinction between exclusive and non-exclusive licenses. They noted that in both situations there is no remaining performance obligation on behalf of the entity after the delivery of license. There was some discussion about whether this should be addressed as a cross-cutting issue with the lease project.

**Disclosure**

*24.* Participants asked the Boards to obtain more input from users to help determine what information should be included in the disclosures. Also, participants stressed the importance of cost-benefit analysis when determining appropriate requirements for those disclosures.

## Implementation Guidance

25. Several participants in various industries requested that the Boards develop industry-specific revenue recognition guidance.

## Transition and Effective Date

26. Several participants noted that the retrospective application of the proposal would be very expensive and nearly impossible because of system limitations. They advised the Boards to set an effective date far enough in the future to allow companies to run dual accounting systems for all years to be presented. Additionally, they highlighted that retrospective application would not only affect revenue, but also other areas such as cost of sales, other income, and related assets and liabilities.

27. Participants commended the staff and Boards for performing great outreach to date. They encouraged the Boards to engage in additional testing of the standard to better understand the operationality of the proposal, especially as it applies to industries and transactions with unique considerations.