Feedback and Pushback:
Stakeholder Input and Other Influential Factors in
the FASB's Adoption of ASC 606- Revenue from
Contracts with Customers

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Abstract: In 2002, the FASB took on a joint project with the IASB to create a single, comprehensive
standard for revenue recognition. ASC 606 replaced the earnings-based model of recognition that, in
practice, could lead to inconsistent, incomparable, rules-based reporting. Users and producers of
financial reports raised concern about the new standard (specifically that the five-step process did not
adequately apply to all industries and practices). The FASB had two main goals in mind when creating
the standard: movement towards principles-based reporting and convergence with international
standards. However, feedback from stakeholders challenged the FASB's proposed model for revenue
recognition, raising concerns regarding not only the new principle but also the execution of the
standard. This study tests the FASB's responsiveness to feedback from stakeholders in the form of
solicited comment letters. Further, it assessed the ability of the FASB to adhere to its goals for the
project while incorporating feedback. The FASB demonstrated high responsiveness to stakeholders
through the explanation, clarification, or modification of components of the standard without
changing the guiding principles. However, anecdotal evidence suggests that the structure and goals of
other organizations, the SEC and the IASB, might thwart the FASB's ability to implement the new
standard as intended.
# Table of Contents

**Introduction** ........................................................................................................ 3  
**Background**  
  Standard-Setting in the United States ................................................................. 5  
  Revenue Recognition Under U.S. GAAP .............................................................. 7  
**Existing Literature** ............................................................................................... 10  
**Research Questions and Methodology**  
  Research Questions .................................................................................................. 13  
  Methodology ........................................................................................................... 14  
**Results**  
  Key Issues for Stakeholders ..................................................................................... 17  
  FASB Adherence to Goals ......................................................................................... 28  
**Limitations** ........................................................................................................... 34  
**Future Work** ......................................................................................................... 36  
**Conclusions** .......................................................................................................... 37  
**References** ............................................................................................................ 40  
**Appendices** ........................................................................................................... 43  
  Appendix I: FASB Rules of Procedure (Due-Process) ........................................... 43  
  Appendix II: 2008 Discussion Paper Questions for Respondents ......................... 43  
  Appendix III: 2010 Exposure Draft Questions for Respondents ............................ 45  
  Appendix IV: Key Terms (2008 Discussion Paper) ............................................... 47  
  Appendix V: Key Terms (2010 Exposure Draft) ................................................. 47  
  Appendix VI: Comment Letter No. 4 (2008 Discussion Paper) ........................... 49  
  Appendix VIII: Key Terms in Order of Frequency (2008 Discussion Paper) ...... 52  
  Appendix IX: Key Terms in Order of Frequency (2010 Exposure Draft) .......... 52  
  Appendix X: FASB Meeting Minutes Regarding Performance Obligations ....... 53  
  Appendix XI: Change of “Performance Obligation” Definition (2011 Exposure Draft) ................................................................. 55  
  Appendix XII: Changes in Determining Transaction Price (2011 Exposure Draft) ................................................................. 56  
  Appendix XIII: Changes/Clarifications in Identifying Separate Performance Obligations (2011 Exposure Draft) ......................... 56
**INTRODUCTION**

In 2002, the Financial Accounting Standards Board (FASB), the standard-setting body for authoritative accounting guidance in the United States, officially added a revenue recognition project to its technical agenda. After twelve years of Board meetings, solicitation and review of constituent feedback, and several draft iterations of the standard, the FASB released Accounting Standards Update (ASU) 2014-09, soon known as Accounting Standards Codification (ASC) Topic 606- Revenue from Contracts with Customers (FASB 2014). This topic replaced the previous standard, Topic 605, which used an “earnings-based” model. The FASB stated the following reason for addressing revenue recognition:

Revenue is a vital metric for users of financial statements and is used to assess a company’s financial performance and prospects. However, the previous requirements of both IFRS and U.S. GAAP were different and often resulted in different accounting for transactions that were economically similar. Furthermore, while revenue recognition requirements of IFRS lacked sufficient detail, the accounting requirements of U.S. GAAP were considered to be overly prescriptive and conflicting in certain areas (FASB 2014).

The new standard revolves around the principle that entities should recognize revenue as it, “Depicts the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services,” (FASB 2014).

Users and producers of financial statements met the new standard with confusion, questions, and skepticism. Stakeholders from a wide variety of industries submitted approximately 1,500 comment letters sharing feedback with the FASB regarding the proposed standard. Although constituents had their own industry-related concerns, it seemed that by and large firms were concerned because the new standard that included a five-step, one-size-fits-all process for all reporting entities differs significantly form the rules-based reporting previously
used. Accounting firms such as PricewaterhouseCoopers, Ernst & Young, KPMG, Baker Tilly, and more have publicly released their own guidance to help firms understand and implement ASC 606.

The development of this standard is particularly interesting because it differs significantly from previous guidance. Given the commotion surrounding the new standard, it is important to understand the evolution of the revenue recognition standard so that one can answer the following question; how did the FASB arrive at the final standard? To understand this, the study becomes familiar with the standard-setting process in the United States and which factors (other organizations, order of procedure, and input from stakeholders) impact it.

To understand the evolution of the standard, this study tracks conversations held by the FASB regarding revenue recognition from the inception of the project to 2017. Comparing the FASB meeting minutes to other inputs, such as comment letters, press releases from the Securities and Exchange Committee (SEC), and the FASB’s partner in the project, the International Accounting Standards Board (IASB), illuminates which factors influence the process. This study also aims to assess the efficacy of stakeholder input on the process. The FASB’s due-process structure requires the Board to seek and incorporate (to the best of its ability) stakeholder input (FAF 2018). Although the FASB should represent the opinions of its constituents, it would seem that the Board would have to make some decisions that self-interested firms would not agree with in order to maintain honesty and transparency for all. Analysis of the influence of stakeholders would assess to what extent the FASB’s due-process model allows for effective standard-setting; does too much input derail the FASB’s intended goals for the new standard?
These tests matter not only because of revenue's importance as a measure of firm performance (both for users and producers of financial statements), but also because the FASB serves a critical role in standard-setting, and it is important to understand the organization’s process so that we can strive for continuous improvement in U.S. Generally Acceptable Accounting Principles (GAAP) standard setting.

**BACKGROUND**

To understand how various factors affected the FASB's process of creating ASC 606, it is important to understand both the process of standard-setting and the history of revenue recognition guidance and reporting.

**STANDARD-SETTING IN THE UNITED STATES**

To ensure that updates to U.S. GAAP achieve their intended impact and adequately reflect the needs of constituents, the FASB, the standard setting body in place, has a thorough process for creation and adoption of updates to accounting standards. Changes to GAAP must go through the following major steps to ensure the Board addresses all potential issues: the appointment of a task force, issuance of a discussion memorandum (DM), deliberation from a public hearing, an analysis of oral and written comments, an official meeting of the FASB, issuance of an exposure draft (ED), and further FASB deliberations (Meier, Alam, and Peason 1996). The extensive process requires the FASB to solicit input from various stakeholders, a key pillar of the organization (FASB Rules of Procedure 2013). Although the FASB cites that third-party feedback as a guiding force in achieving its mission of comprehensive and effective accounting guidelines (FASB Rules of Procedure 2013), the Board has historically struggled to garner a sufficient amount of input from its constituents affected by the policies (Tandy and
Community involvement is crucial to supporting the achievement of the FASB’s mission; it employs critical problem-solving methods (both in identification of issues and exploration of solutions) that make for a more thorough standard-setting process (Tandy and Wilburn 1992). Although the FASB creates authoritative guidance, the SEC serves as the legal and fiduciary enforcer of public financial compliance; incorporating stakeholder feedback to create standards that represent the opinions of the people established a sense of authority, giving constituents a reason to respect the FASB as a significant pillar of the accounting community (Tandy et al. 1992). Constituents that potentially have stake in the FASB’s rulings include users, preparers and auditors of financial statements (Tandy et al. 1992). The FASB incorporates input from these constituents, in addition to input from independent third-parties such as academic organizations, as a part of the due-process the Board has created to update and amend the Accounting Standards Codification (ASC) (Meier et al. 1996).

Lobbying efforts not only ensure that diverse opinions are heard by the FASB but also help to realistically assess the potential costs and benefits of proposed standards (Meier et al. 1996). In addressing the unavoidable implementations costs of changes to the ASC, Meier et al. states, “At a minimum, some implementation costs are incurred every time a proposed accounting standard is adopted. Ideally, though, the benefits derived from higher quality accounting information exceed the sum of these implementation costs.” Given the FASB’s significant change to the recognition process for top-line revenue, compliant firms must incur costs to update their technical software to the new method, and the FASB organization itself must facilitate costly meetings, issue implementation guidance, and coordinate efforts among several organizations (G. Hendler, personal communication, November 20, 2017). To complete
the cost benefit analysis inherently embedded in the FASB’s guiding principles, one must consider the goals of the proposed standard (in this case, ASU 2014-09).

**Revenue Recognition under U.S. GAAP**

Revenue is the most frequently recurring feature of financial statements, carrying great significance to both internal and external assessments of a firm’s success (Schipper, Schrand, Shelvin, and Wilks 2009). The FASB's new standard replaces an “earnings-based” model of revenue recognition. In that model, revenue was recognized once it was both realized/realizable and earned. However, guidance presented for this model beyond the two criteria was scattered and industry specific, as there was not a, “general revenue recognition standard in the US authoritative literature,” (Schipper et al. 2009). The FASB presented guidance on revenue recognition in the form of official Statements, Interpretations, and EITF issues. Stakeholders could also look to the American Institutes of Certified Public Accountants (AICPA) or the SEC for further counsel (Schipper et al. 2009). These resources focused on guidance specific to various practices and industries and totaled more than 200 different pronouncements, as they were added ad hoc when needed (Schipper et al. 2009).

Several factors guided the FASB in its decision to take a closer look at, and eventually revise, revenue recognition standards in the United States. Specifically, the FASB identified issues regarding the treatment of revenue recognition under GAAP and advancements to be made that extended beyond the boundaries of previously existing guidelines. In terms of improvements, the vast variation in guidance from a plethora of organizations and multitude of pronouncements for revenue recognition under GAAP made the previous framework difficult to interpret and led to inconsistencies in reporting (Schipper et al. 2009). Restatements due to revenue recognition errors can likely be attributed to these disparities (Schipper et al. 2009).
Cascini, DelFavero, and Bezner (2014) have found that these common restatements resulting from revenue recognition errors can significantly impact shareholder value, citing a short-term average of about a ten-percent decline in firm performance.

Not only did the FASB's objectives for the revenue recognition project include improvements to problems already encountered by users, but also the Board aimed to make proactive changes to its guidance in regards to international comparability and shifts towards a service-based economy. Attaining international convergence with existing IFRS standards is a primary goal of the ASU (Schipper et al. 2009). Given the IASB's use of principles-based accounting, implementing a framework approach (the five-step process applied to all industries) would allow GAAP to make another step towards comparability for firms across different markets. Because the FASB has made convergence one of its primary goals for the revenue recognition project, it has been working alongside the IASB since 2002 to create a single standard for both organizations (Ciesielski et al 2011). In the same way that the FASB strived to create broader guidance that will not require constant maintenance and minute details, the IASB aimed to focus its broad framework so that users could apply it to specific situations with confidence (Ciesielski et al 2011).

With the United States economy shifting from a manufacturing to a service-based economy, accounting revenue recognition standards were not adequately equipped to accommodate for evolving business practices, specifically related to the creation of service contracts and transfer of intangible goods (Schipper et al. 2009). Although certain lines of guidance addressed specific industries or transactions, the codification lacked any general guidance for the service industry as a whole (Ciesielski and Weirich 2011). In addition, industry-specific guidance created non-comparability challenges, as users of financial statements
struggled to discern if or why differences existed in reporting practices between firms (Schipper et al. 2009).

The FASB’s decision to overhaul its revenue recognition standards has not been accepted by the accounting community without controversy. Some critics of the new standard have stated that they understand the macro-level concept of convergence but fear that the approach is not practical (Cascini, DelFavero, and Bezner 2014). Due to IFRS’s principles-based approach, international firms and auditors have historically used GAAP’s more specific, rules-based standards for guidance in making revenue recognition decisions (Stice, Stice, and Skousen 2010). Stice et al. posit that removing this industry-specific guidance may result in either other non-authoritative sources serving as primary references, or the eventual reversion to rules-based guidance. These critics have stated that the benefits of international convergences would not be worth these setbacks (Cascini et al. 2014).

Skeptics of the new standard have also expressed uncertainty about the efficacy of the new method of revenue recognition (Ohlson, Penman, Biondi, Bloomfield, Glover, Jamal, and Tsujuyama 2011). Given the previously outlined shift to principles-based direction, accountants have warned that there must still be clear guidance as to what is and is not considered acceptable accounting, and the language of the codification itself must allow for readers to apprehend practical solutions to real accounting challenges (Ohlson et al. 2011). Further, the emphasis the new standard places on expectations of future actions taken by the customer in its five-step process has raised concerns; although accountants have relied on estimates for accrual-based accounting, avoidance of estimates, where possible, circumvents subjectivity and risk (Ohlson et al. 2011). To compensate for the increased leniency towards estimations, the new standard requires extensive qualitative and quantitative disclosures regarding methodology behind the
financial statement reports (Ciesielski et al. 2011). However, these doubts regarding estimation remain, despite the FASB’s new policy relating to revenue disclosures.

Regardless of whether or not the proposed new standard will achieve its intended goals, critics have expressed uncertainty as to whether the nature of revenue recognition guidance needs to change in the first place, that is, to shift towards principles-based accounting. Through the use of detailed implementation guidelines, the FASB has seen the following benefits: increased comparability and verifiability, smoother facilitation of enforcement and reduction of litigation (Schipper 2003). However, Katherine Schipper observes that even these effects can tow a fine line between being beneficial and detrimental, saying the following:

Specific guidance on how to apply a standard should reduce the effects of differences in professional judgement. But to the extent that the guidance is inappropriately strict, the result will be surface comparability, and dissimilar arrangements will be forced into the same accounting treatment. It is not clear whether increasing the amount of detailed guidance increases this risk. (Schipper 2003).

Both the FASB and the SEC have invested resources to investigate the implications of principles-based as opposed to rules-based accounting, both for those using financial reports and those producing them (Schipper 2003). In 2004, the FASB released a statement officially supporting movement towards principles-based reporting under U.S. GAAP; this study investigates the progression and application of this movement within the context of revenue recognition (FASB 2004).

Existing Literature

Most accounting research and literature focuses on the effectiveness of the FASB’s standard-setting process, including the role of feedback from stakeholders. Given that ASC 606 will not fully go into effect until fiscal year ending 2018, scholars have yet to analyzing the process of adopting or implementing the standard or assessing the result of the standard on
financial reports. However, scholars have published work expressing their opinions based on the process prior to the release of the final standard in 2014. This expressed interest indicates that more work is to come regarding this significant standard.

Scholars assess the FASB’s ability to effectively communicate with constituents and the efficacy of its standard-setting policies. Pike and Chui (2012) assess existing criticisms of the FABS’s conceptual framework, specifically that it began to devolve to a rules-based system. The users of financial statements have expressed concern primarily relating to reliability, how reliability related to intentions, and how that factor affected their decision-making process in assessing firms (Pike and Chui 2012). Pike et al. posit that the FASB’s conceptual framework for standard-setting, however, has placed too much emphasis on identifying relevant material for users while neglecting reliability. Further, the rules-based nature of standard-setting makes familiarity with GAAP difficult to achieve, as one must have access to specific rules as opposed to a broad understanding of principles. Pike and Chui argue that financial accounting standards are not adequately accessible to users of financial statements and that understanding of GAAP is currently limited to those who are well-versed in the codification.

Greenspan and Hartwell (2009) also assess the efficacy of the FASB’s conceptual framework, conversely finding that conceptual frameworks, when properly utilized, help move towards principles-based reporting. Their assessment of the purpose of a framework, as opposed to line-item codification, is that the FASB should aim to provide comprehensive guidance for firms that could be transposed to many different scenarios; having a broad framework would allow for all standards developed to incorporate the fundamental accounting principles. When there is no such framework, the FASB had developed standards ad hoc and deviated from the salient accounting theories (Greenspan and Hartwell 2009). In their assessment of the FASB’s
quest to improve its comprehensibility, Greenspan and Hartwell believe that based on the SFASs released by the FASB, the Board has the potential to move towards principles-based reporting.

Given the importance of maintaining some form of consensus amongst firms regarding accounting standards, Saemann examines the relationship between corporate constituents and the FASB in the standard-setting process. Her study confirms previous assessments that the FASB has been adequately responsive to opinions formally offered by corporations (Saemann 1995). Further, using the process of changing GAAP regarding accounting for pensions as an example, Saemann finds that opposing comment letters from corporations declined as the FASB made amendments to the standards during the comment letter solicitation period. This indicates increased corporate consensus (Saemann 1995). Saemann concludes that input from corporations is well-received, and she urges firms that have opinions different than those of the FASB to participate in the comment letter process.

Although the FASB creates GAAP, different parties have influence on the decisions made by this private organization. Specifically, Palmon, Peytcheva, & Yezegel (2011) find that the SEC has played a significant role in the standard-setting process, despite the perception that its involvement has been passive. A variety of standard-setting practices on the FASB’s behalf are shown to correlate strongly to deliberate actions and announcements from the SEC, including the stances the FASB takes on accounting issues (Palmon et al. 2011). The authors explain the difference between responsibility and power; while the SEC has power, it occasionally takes on the responsibility of standard-setting, diminishing the authority of the FASB.

Palmon et al. also criticize the federal government’s inadequate intervention in accounting regulation. In response to the infamous accounting scandals at the turn of the twenty-first century, Congress responded by issuing the Sarbanes-Oxley Act of 2002 to limit the extent
to which accountants could consult for their clients; they argue that this does not address the underlying issue of insufficient accounting principles and the need for standard-setting reform.

Although the academic literature on this revenue recognition standards matter is not extensive, scholars express interest in assessing the process of adopting a principles-based revenue recognition standard. For example, Marianne James of California State University published a case study subsequent to the FASB's exposure draft release in 2010 requiring students to assess the conceptual changes between the existing norms for revenue recognition and the proposed change. This study, used for academic purposes, challenges accounting students to critically assess the new standard and how it will impact financial reports.

**RESEARCH QUESTIONS AND METHODOLOGY**

This study examines two research questions through the use of content analysis of stakeholder comment letters and the creation of a comprehensive timeline of important discussions held by the FASB.

**RESEARCH QUESTIONS**

1. What is the stakeholder influence on the FASB during the revenue recognition standard-setting process from 2002 to 2017?

This first question aims to test to what extent the FASB adheres to its high standards for constituent involvement as prescribed in its Rules of Procedures (Appendix I). According to the literature on accounting standard-setting in the United States, the FASB historically has struggled to garner opinions via comment letters. With over 1,500 comment letters received on the topic of revenue recognition from 2002 until 2017, the FASB has the opportunity to understand and address concerns raised by stakeholders; did the FASB utilize this feedback to amend the proposed standard?
Given the many iterations of the proposed standard released throughout the timeline of the revenue recognition project and given the subsequent Accounting Standards Updates, I hypothesize that FASB has a high responsiveness to stakeholders. However, the consequences of responsiveness has the potential to extend beyond simply reflecting a diverse set of opinions. To understand the consequences of this responsiveness, the study also examines the following question:

2. If stakeholder input significantly affects the standard-setting process, is the FASB able to incorporate feedback without compromising its ability to move towards principles-based standards and international convergence?

This second question is important because it assesses the efficacy of the FASB’s standard-setting process and policies.

**METHODOLOGY**

To test these two questions, this study employs two forms of qualitative analysis. First, content analysis of the comment letters submitted to the FASB regarding the proposed standard illustrates which concerns the stakeholders expressed by and large. The comment letters were sorted into the corresponding comment periods associated with the release of a due-process document and uploaded to Voyant Tools, a digital platform that identifies data related to where and how frequently terms appear in a batch of documents. Prior to data collection from Voyant Tools, I created a list of key terms which one would expect to appear based on the content of each due-process document. The terms reflect key areas the FASB solicited feedback on, as identified in the “Questions for Comment.” Question Five from the 2008 Discussion Paper released by the FASB serves as an example of key terms reflecting issues raised by constituents. The question reads:
Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? [Appendix II, Question Five]

The appearance of the terms “separate,” “performance,” “obligation,” and “transfer,” in a comment letter indicate that the issues from question five are addressed by the author of said letter. This process was iterated for all questions posed by the FASB in its due-process documents, and the terms extracted from the questions comprised the “Key Terms” list. These questions covered a wide array of topics introduced in the corresponding document, and therefore serves as an adequate reflection of the document itself. The questions from the 2008 and 2010 due-process documents can be found in Appendix II and Appendix III respectively. Further, Appendix IV and Appendix V list the key terms garnered from these questions for 2008 and 2010 respectively. This form of analysis identifies important issues, but it does not reflect opinions of stakeholders (either positive, negative, or a combination of the two).

Additional terms were added after data collection from Voyant Tools to the “Key Terms” because they turned out to be significant. For example, the term “guidance” was included in analysis of issues important to stakeholders for both the 2008 and 2010 comment periods. Although none of the FASB questions solicited feedback regarding the quality or quantity of existing guidance, many stakeholders addressed the need for additional guidance to ensure successful implementation of the proposed standard. Comment Letter No. 4 included the following statement, illustrating the use of the term “guidance” in comment letters:

However, we consider that more guidance and/or illustrative examples are necessary to make clear the distinction between the entity satisfying a performance obligation in the contract… and the activities that an entity undertakes in producing those goods and services. Without further guidance and/or illustrative examples we are concerned that prepares will have difficulty in operationalizing the contract-based revenue recognition model for particular industries or sectors. [Appendix VI]
This serves as an illustration of how the list of key terms gained new additions during
the process of data collection.

Data from Voyant Tools reflected which terms appeared most frequently in the corpus of
documents. The list of terms in order of frequency was then reduced to include only those terms
that related to substantial content (i.e. “Key Terms). Looking at something this way demonstrates
which topics stakeholders feel the need to address or bring to the FASB’s attention. This process
allowed me to search subsequent meeting minutes and due-process documents for the inclusion
of specific issues (issues raised by stakeholders) in discussion.

To assess the stakeholders’ opinions on these issues, this study utilized Voyant Tools’
“Words in Context” function. The FASB posed the majority of its questions to respondents in a
way that solicited a response stating either, “We agree with…” or, “We disagree with.” Referring
again to Question Five, the question reads:

Do you agree that an entity should separate the performance obligations in a
contract on the basis of when the entity transfers the promised assets to the
customer? Why or why not? [Appendix II, Question Five]

Stakeholders typical responded in a reflexive manner, either restating the question exactly before
stating an opinion, stating agreement or disagreement with a question in the beginning of their
answer, or some combination of the two. A typical response resembled that of the response to
Question Five in Comment Letter No. 24:

We broadly agree with the principle that performance obligations should be
separated on the basis of when an entity transfers the promised assets to the
customer… [Appendix VII]

Taking this into consideration, the words “agree” and “disagree” were extracted in context
(fifteen words before and fifteen words after the term) to determine which topics the respondents
either supported or disagreed with.
With stakeholder input analyzed, the study then follows changes, clarifications, or explanations the FASB makes to its proposed amendment. To track responsiveness, meeting minutes and subsequent due-process documents were assessed to identify which components of the standard were modified. These changes were compared to the issues identified by stakeholders to assess whether or not the FASB responded directly to stakeholder input.

The creation of a comprehensive timeline allowed for analysis of the FASB’s adherence to its stated goals. This timeline is comprised of content pulled from public meeting minutes available on the FASB’s website. By following deliberations and decisions in meetings over the course of the revenue recognition project, the study tracked changes in the FASB’s commitment to principles-based reporting and international convergence. Additionally, the timeline includes events/statements from two bodies that exert influence in the process of adopting the revenue recognition standard: the SEC and the IASB. This inclusion allows for analysis of changes in discussion in conjunction with potential outside influences, recognizing that outside factors affect the FASB’s decisions.

**RESULTS**

**KEY ISSUES FOR STAKEHOLDERS**

The quantitative analysis of comment letters received after the 2008 discussion paper reflects that a wide variety of topics concerned stakeholders; however, stakeholders most frequently addressed performance obligations and related topics.\(^1\) The comment period following the FASB’s release of *Discussion Paper: Preliminary Views on Revenue Recognition in*...

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\(^1\) Many of the iterations of key terms included in this analysis are derived from restatement of the FASB’s questions, as stakeholders typically include the exact question for reference in their comment letters. However, inclusion of a question indicates that the author of the comment letters intends to address that question. Given this trend, it is appropriate to include appearances of key terms taken from restatement of FASB’s questions in the analysis of which issues stakeholders found most pressing.
Contracts with Customers lasted from the publication of the paper on December 19th, 2008 until June 19th, 2009. Cumulatively, stakeholders submitted 226 comment letters. Of these letters, this study analyzes 220, collectively using Voyant Tools. Figure 1 displays the most frequently occurring key terms in this corpus.

**Figure 1: Frequency of Key Terms from Comment Letters (2008 Discussion Paper)**

The second most frequent term, “obligation,” appears 6,607 times throughout the corpus, and the third most frequent term, “performance,” appears 5,934 times. The term “contract” occurs most frequently; however, random examination of comment letters reveals that this trend typically reflects stakeholders referring to the proposed standard, not necessarily expressing concerns with the definition of revenue or use of a contract. This evidence supports the conclusion that performance obligations were a significant topic of discussion for the 2008 discussion paper.

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2 Although all 226 comment letters were uploaded using the Voyant platform, the program was unable to read and pull content from all letters (especially since most letters were PDF scans of printed letters). Because of this, I only used the letters that Voyant Tools could pull data from.
Other topics stakeholders raised include the role of the newly defined contract asset in revenue recognition, treatment of costs associated with obtaining a contract, and the definitions of various terms specific to the proposed standard. However, many other frequently occurring terms correspond to specific issues regarding the treatment of performance obligations. Specifically, stakeholders addressed measurement (including price allocation), transfer (of control), and separation of performance obligations. A complete list of key terms in order of frequency can be found in Appendix VII.

Comparing the content of comment letters from after the 2008 discussion paper to that of the comment letters from after the 2010 exposure draft reflects that stakeholders primarily discuss the nature of performance obligations in the proposed standard; however, other topics either rise or fall in priority for authors. After the release of *Proposed Accounting Standards Update: Revenue Recognition (Topic 605)* on June 24th, 2010, stakeholders had until October 22nd, 2010 to respond to the FASB. Out of the resulting 974 comment letters, 817 are included in the Voyant Tools analysis. ³ Figure 2 displays the most frequently occurring terms in this corpus.

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³ See Explanatory Note #3.
The term “obligation” appears 7,207 times in the corpus, and the term “performance” appears 6,751 times. Similar to the 2008 corpus of comment letters, these two terms rank second and third in number of iterations among all key terms. However, other terms shift in their ranking among one another. Specifically, the term “guidance” rose from fifteenth in 2008 to sixth in 2010, whereas “asset” fell from fourth to ninth. Further inquiry reveals that this reflects the comment letters from the 2010 comment period, focusing less on grasping the idea of revenue as a change in net contract assets and liabilities and more so on implementation of the standard. In 2008, the FASB just introduced this innovative concept of revenue recognition; stakeholders during that comment period raised broad questions about the standard and the theories behind it. However, the exposure draft released in 2010 was more thorough than its predecessor, and it more closely resembled an operational standard as opposed to a theoretical concept. For
example, the 2008 due-process document contains a total of eight concrete examples of application for the proposed standard; the 2010 document contains thirty-one.

Stakeholders in 2010 also began to discuss disclosures in their comment letters, the eighth most frequent key term. This term does not rank within the top three-hundred most frequent terms in 2008. This drastic jump coincides with the introduction by the FASB in 2010 of extensive disclosure requirements within the proposed standard. Similar to the rise in iterations of “guidance,” this increase reflects stakeholders’ desire to grasp what the standard would look like in practice. Appendix IX contains the complete list of “Key Terms” in order of frequency from the 2010 exposure draft.

Given the high iteration rate of “performance” and “obligation,” this study specifically tracks issues related to performance obligations and how the FASB responds to those concerns. Revenue from contracts with customers covers a wide variety of specific topics; whereas most FASB accounting standards updates amend specific aspects of already existing topics, this ASU completely replaces the existing guidance, Topic 605. Responsiveness to performance obligation questions and concerns serves as a case study of how the FASB interprets and incorporates feedback.

**RESPONSIVENESS TO STAKEHOLDER CONCERNS: PERFORMANCE OBLIGATIONS**

Comment letters from 2008 typically express support of the principle of recognizing revenue as proposed by the FASB but disagree with specific components of the standard and their operationality. The corpus of 220 comment letters responding to the discussion paper contains a total of 115 statements in agreement and 70 statements in disagreement with some aspect of the standard (Figure 3).  

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4 The two columns of comment letters in Figure 4 are not mutually exclusive. There are documents that contain both “agree” and “disagree” statements. Further, many of the letters from the corpus do not contain either
However, more documents contain statements expressing some form of disagreement than agreement: 45 versus 18 (Figure 4). Stakeholders largely support the standard but want more information and guidance.

“agree” or “disagree” statements. These letters typically comment on the feasibility of the project overall, expressing overarching support or dissent. These letters do not respond to specific questions posed by the FASB, and therefore are excluded from this analysis.
Out of all 70 statements of disagreement, 34 pertain to the nature and treatment of performance obligations (48.6%). Stakeholders express concern regarding the definition, measurement, and classification/identification of performance obligations.\(^5\)

After the end of the comment period, the FASB met fifteen times; four of those times the Board discussed the nature and treatment of performance obligation. The FASB refers to these meetings as redeliberations, meetings in which the two boards reevaluates or elaborates on topics previously covered based on input via comment letters. The meeting minutes do not reflect the deliberations between board members and options considered, only the outcome of the conversations. Even though one cannot determine how the FASB received feedback from comment letters, the inclusion of performance obligation as a meeting topic reflects consideration by the FASB of a salient topic for stakeholders. In these meetings, the two boards specifically discussed identification, transaction prices allocation, separation, and measurement (and subsequent measurement) of performance obligations (Appendix X contains excerpts from meeting minutes regarding decisions reached).

Although meeting minutes reveal that the FASB reconsidered components of the performance obligation, the content in the subsequent due-process document reveals how the FASB chose to address stakeholder concerns. The FASB directly addresses issues raised through the comment letter process in the 2010 exposure draft, responding to its constituents in one of three ways: clarification, additional explanation, or modification. For example, the FASB

\(^5\) It is important to note that stakeholders did not agree on most issues, including nature and treatment of performance obligations. However, as illustrated in the FASB’s Rules of Procedure, the organization is required to carefully consider all constructive comments. Although some constituents supported the FASB’s propositions regarding performance obligations, given the significant frequency of concerns raised, it would deviate from the FASB’s due-process to ignore these topics.
responds to confusion regarding the segmentation of performance obligations by clarifying why
the process was necessary. In the 2010 exposure draft, the Board states:

During consultations following publication of the Discussion Paper, some
preparers of financial statements questioned the need for a contract segmentation
principle in addition to the requirements for identifying separate performance
obligations in a contract… The two boards decided that a segmentation principle
was needed to:
(a) simplify the assessment of scope—if some goods or services in the
contract are priced independently and are within the scope of other standards,
the contract segmentation principle would require an entity to segment the
contract and account for each of the resulting identified contracts in
accordance with the relevant standard; and
(b) determine the promised goods or services to which an entity should
allocate proportions of the transaction price—if a contract has a variable
transaction price, the proposals require an entity to allocate changes in the
transaction price to all performance obligations in the contract. If the prices
of some goods or services are independent, an entity would account for the
goods or services (and the corresponding transaction price) as a separate
contract. Hence, the entity would not allocate changes in the transaction price
of one bundle of performance obligations identified as a contract to another
bundle of performance obligations identified as another contract (FASB
2010).

The Board also was willing to change previous decisions outlined in the discussion paper
based on constituent feedback. For example, many stakeholders did not believe that the right of
return should be classified as a separate performance obligation. In response, the FASB includes
the following in its 2010 exposure draft:

In light of the feedback from respondents and the Boards’ subsequent decisions
on variable consideration, the Boards refined their analysis of rights of return. The
Boards concluded that contracts with a right of return typically include at least
two performance obligations—a performance obligation to provide the good to
the customer and a performance obligation for the return right service, which is a
stand-ready obligation to accept the goods returned by the customer during the
return period.

This change ensures that entities would not recognize revenue as goods are returned to
them.
Overall, evidence from the frequency analysis and meeting notes suggests that the FASB responds thoroughly and directly to comment letters regarding the treatment of performance obligations in the 2008 discussion paper. The comment letters from after the release of the 2010 due-process document do not express the same degree of disagreement with performance obligations. The comment letter corpus displays similar results to the 2008 comment period in terms of levels of agreement and disagreement. The corpus includes 516 total statements of agreement, and only 332 statements of disagreement (Figure 5). However, more documents overall still contain “disagree” statements (Figure 6).

**Figure 5: Number of Statements in Agreement or Disagreement (2010 Exposure Draft)**
The 2010 corpus reflects a narrowing gap between documents containing “agree” and “disagree” statements (Figure 4 and Figure 6). Compared to the 2008 comment letters, these comment letters express fewer specific concerns and typically request additional information or guidance instead of strongly disagreeing with propositions.

This corpus also reflects that stakeholders show less disagreement regarding the nature and treatment of performance obligations in this version of the proposed standard as opposed to that of 2008. Out of the 332 statements of disagreement, only 25 address topics related to performance obligations (a decrease of 41.1% from the letters responding to the previous due-process document).

Evaluating anecdotal evidence in this particular case, the FASB again displays substantial responsiveness to issues raised by stakeholders concerning performance obligations in

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6 The use of the phrase “less disagreement” was intentionally included as opposed to “agreement.” This study specifically tested concerns raised by stakeholders; although this stakeholders no longer disagreed, I cannot say that they expressed agreement.
subsequent redeliberation meetings and in the 2011 exposure draft. Only one of the fifteen meetings regarding the 2010 guidance included performance obligations in its agenda. However, this proportion is adequate given the decreased quantity of concerns raised in response to the FASB’s questions regarding performance obligations. Further, the FASB had a wide array of other topics to discuss and a very limited time to do so (see List of Redeliberation Topics on Timeline: 2011). During this meeting, the FASB explored the following salient issues from comment letters: the definition and identification of performance obligations, the treatment of onerous performance obligations, and the determination of transaction prices (Appendix XI).

In its 2011 exposure draft, the FASB directly responded to stakeholders regarding performance obligations. Similar to the response to constituents in the 2010 draft, this draft does not substantially change the underlying principles of the proposed standard. Rather, the FASB responds to feedback through further clarification or modification of smaller components. For example, the FASB amends the definition for performance obligation by eliminating the term “enforceable” after stakeholders expressed the need to account for some performance obligations that would not be enforceable. This response changes the scope of what does and does not classify as a performance obligation. In the draft, the FASB states the following:

Respondents to the 2010 proposed Update expressed concerns about the term enforceable because they thought that an entity should account for some promised goods or services as performance obligations even though the promise to transfer those goods or services may not be enforceable (for example, some when-and-if-available software upgrades and award credits associated with customer loyalty programs). Consequently, the Boards decided that although a contract with a customer must be enforceable, a performance obligation could arise from a promise associated with a contract if the customer has a valid expectation that the entity will transfer a good or service. (Appendix XI)
Similarly, the FASB amends its definition of “transaction price” to refer to the amount to which the entity expects to be “entitled” as opposed to “received.” Further, the Board decided to no longer include credit risk as a component of the truncation prices (Appendix XII).

In addition to the above modification, The FASB provided further clarification on certain issues. For example, the FASB observed confusion in the comment letters regarding how to identify separate performance obligations. As a result, guidance for significant contract management service, a source of confusion for stakeholders, becomes part of the standard itself. Further, the Board removes the reference to distinct profit margins (Appendix XIII).

Issues related to transfer of control serve as another example of the FASB providing further clarification, responding to stakeholders without changing the proposed standard. When stakeholders expressed confusion as to when entities should determine the transfer of control, the Boards added an additional gauge for entities to use. The inclusion of “risks and rewards of ownership” in identification of transfer of control provides yet another measure to clarify the transfer has occurred. These examples provide anecdotal evidence supporting the claim that the FASB (in the case of issues relating to performance obligations) exhibits a high degree of responsiveness to solicited comment letters.

**FASB Adherence to Goals**

Given that firms will not have widely adopted the guidance from ASC 606 until its implementation deadline for the fiscal year end of 2018, this study could not definitively conclude whether or not the FASB adhered to its goals of international convergence and principles-based reporting. However, the compilation and analysis of a comprehensive timeline of developments from 2002 to 2017 reveals that this standard will likely not achieve the FASB’s goals by the time of implementation. The FASB makes its goals apparent to stakeholders during
the early phases of the project, working with the SEC and the IASB to ensure cohesive aims. From the project’s inception until the release of the first due-process document in 2008, the FASB stayed on track to achieve its goals. However, from 2008 until the joint release of the final standard in 2014, the relationship between the FASB and the IASB unraveled. Finally, during the still ongoing implementation stage, evidence suggests that reporting entities will likely revert to the same rules-based reporting methods employed prior to the project, regardless of the FASB’s guidance.7

The regulatory environment at the beginning of the revenue recognition project shaped the FASB’s goals for the new standard. In 2002, the United States government enacted the Sarbanes Oxley (SOX) Act as a federal law in response to accounting scandals, such as Enron and WorldCom (SEC 2013). The Act focused on reform in both corporate responsibility and accountability of financial reports; it required the SEC to conduct a feasibility study of implementing principles-based reporting standards for U.S. GAAP (SEC 2009). The conjunction of this push for principles-based accounting and the beginning of the revenue recognition project shaped the discussions the FASB had in its meetings. In its 2003 publishing of findings based on the feasibility report, the SEC stated that U.S. GAAP should have the following characteristics:

- “Be based on an improved and consistently applied conceptual framework;
- Clearly state the accounting objective of the standard;
- Provide sufficient detail and structure so that the standard can be operationalized and applied on a consistent basis;
- Minimize the use of exceptions from the standard.” (SEC 2003)

In 2004, the FASB officially agreed with the SEC’s recommendations to move towards principles-based reporting (see Timeline: 2004).

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7 Based on interviews with partners working with firms currently implementing the standard and interviews with accountants in the healthcare industry (an industry that originally expressed concern regarding the application of the principles-based standard to its unique practice).
In moving towards international convergence, the FASB partnered with the IASB in multiple capacities. At a joint meeting on September 18th, 2002, the two boards issued a Memorandum of Understanding known as the Norwalk Agreement (see Timeline: 2002). The memorandum relayed a joint commitment to work towards greater comparability of standards and coordination of efforts. Although international comparability had been raised as an ideal goal prior to 2002, this meeting adopted concrete measures to the convergence and tangible steps (accompanied by specific deadlines) that the boards would take. The boards declared the following items as high priority (FASB 2002):

- “Undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and International Financial Reporting Standards (IFRSs, which include International Accounting Standards, IASs);
- Remove other differences between IFRSs and U.S. GAAP that will remain at January 1, 2005, through coordination of their future work programs; that is, through the mutual undertaking of discrete, substantial projects which both Boards would address concurrently;
- Continue progress on the joint projects that they are currently undertaking; and,
- Encourage their respective interpretative bodies to coordinate their activities.”

In September of 2002, the project officially became a joint venture between the FASB and the IASB.

From 2002 until 2008, the FASB both exhibited a high degree of international cooperation and framed its discussions in a way conducive to the creation of a principles-based standard. In joint meetings during this time period, the FASB and IASB discussed the formation of revenue principles, focusing on guiding principles as opposed to specific rules. The order in which the Boards added various components to the standard supports this observation. First the boards focused on defining revenue; by understanding what revenue was, only then could they decide how to recognize it (see Timeline: 2003). After the boards settled on a definition did it assess possibilities for various views of revenue. The FASB considered four distinct views of revenue presented by its staff (see Timeline: 2003- January 23). Although the Board rejected two
of the views outright, it debated two favored views, the extinguish-based model (also known as liability extinguishment) and the performance-based model (also known as broad performance), eventually deciding on the extinguish-based model. These conversations occurred before the FASB began to address how specific examples would be folded into the concept. For example, the FASB spent two years discussing principles before it debated how comprehensive incomes and gains fit into the revenue recognition framework (see Timeline: 2004- April 23). Rather than scripting specific rules for different forms of revenue in relation to income, similar to the ad hoc process that preceded this project, the FASB aimed to adhere to its underlying principles for this concept and incorporate the specifics afterwards. Given the close cooperation with the IASB and the careful order of topics discussed, the FASB was on track to reach its goals for the revenue recognition project until 2008.

After the FASB released the 2008 discussion paper, Board conversations shifted towards industry and practice-specific guidance, and the FASB and the IASB began to diverge. Once the FASB’s shared its proposed principles for revenue recognition with constituents, the organization continued with redeliberations based on the input from stakeholders via the comment letter process and various roundtables sessions. Meetings from 2009 to the release of the final standard in 2014 delved into specific topics that fall under the umbrella of revenue recognition in contracts with customers but not addressed by the Discussion Paper. For example, in the June 10th meeting of 2009, the Board discusses the logistics associated with various types of revenue recognition: gross versus net presentation of revenue; combinations, segmentation, and modification of contracts; and nonmonetary exchanges. The Board, in conjunction with the IASB, broadened the scope of its discussions regarding logistics after feedback from its 2010
Exposure Draft; the Timeline lists the vast array of topics addressed in these conversations (see Timeline: 2001- FASB & IASB Redeliberations).

Although the 2009 to 2014 meetings were not strictly principles-based, one cannot conclude that this indicates a deviation from commitment to principles-based reporting; rather, this possibly reflects an investigation into operationality. Once the boards established the concepts supporting the proposed revenue recognition model, they addressed implementation and the logistics of applying the principles to actual financial documents. However, this time period of deliberation and refinement of the standard should be seen as a test for the FASB. The Board was challenged with sticking to its concept of revenue recognition and providing guidance for implementation across various practices without losing hold of the principles and reverting to rules-based reporting.

The FASB and the IASB drifted apart from each other (within the context of this project) during redeliberations; ultimately, convergence became unattainable. As late as November of 2009, both of the boards affirmed their commitment to the Norwalk Agreement and the Memorandum of Understanding of 2006 (see Timeline: 2009- November). While the boards were working out what changes would be made to the revenue recognition standard leading up to the release of a second due-process document, the FASB hosted six joint meetings with the IASB over the course of five months (see Timeline: 2010- January through May). However, even while hosting joint meetings, the boards began to disagree on decisions being made. For example, in the February 16th, 2010 meeting, the FASB expressed its desire to prohibit early adoption of the new revenue recognition standard; conversely, the IASB tentatively agreed to allow early adoption for users new to IFRS, even considering retroactive adoption.
Beyond transition guidance, the boards diverged on substantial subjects that affect the operationality of the standard itself. In 2012, the boards came to opposite conclusions regarding whether or not to include a collectability recognition threshold (see Timeline: 2012- Slide 2). In joint meetings prior to the 2008 discussion paper, the two entities were almost always referred to collectively as “The Boards”, given the fact that decisions were made in unison. However, the meetings held in the years leading up to the release of the final standard sometimes identify the Boards separately, even during joint meetings.

From 2012 to 2013, the boards held joint meetings regarding redeliberations less frequently than they had done previously. By March of 2013, the FASB was hosting meetings without the IASB regarding redeliberations of the proposed standard, even though the subject matter of the meetings was no less significant than in previous redeliberation joint meetings (disaggregation of revenue, disclosure requirements, transition guidance, etc.). By 2014, it became clear that convergence between U.S. GAAP and IFRS would not be achieved.

Although convergence was no longer a realistic goal for the FASB, the two boards cooperated through the end of the revenue recognition project. The boards issued the joint standard together in 2014 for their respective constituents. Further, they offered guidance for the transition to implementation by creating a joint Transition Resource Group (see Timeline: 2014-June 3rd) and hosting a joint webcast (see Timeline: 2016- September 15th). Although these efforts support the idea that tolerance existed between the boards, the nature of their relationship had changed significantly by the release of the final standard. Whereas due-process documents released by the FASB in 2008, 2010, and 2011 still referred to goals of comparability, updates to the proposed standard after 2014 excluded terms such as “convergence,” “IASB,” and “joint,” (see Timeline: 2015-August).
LIMITATIONS

Readers of this study should evaluate all conclusions in the context of several limitations. First, this study does not include analysis of all forms of stakeholder feedback. According to the Financial Accounting Foundation, the FASB must solicit input from stakeholders not only through comment letters but also through public hearings and/or roundtable meetings (at minimum) (FAF 2018). While the FASB published some of the roundtable meeting discussions, such as the three round tables held in the winter of 2010, not all meetings are publicly available on the FASB’s website. Sentiments expressed by attendees of the roundtable (from which minutes were accessible) echo those expressed in comment letters; vocal stakeholders typically supported the revenue recognition principle but expressed concern regarding how the standard would apply in their specific industry. The roundtable meeting minutes accessed by this study also demonstrates the FASB’s commitment to due-process and solicitation of a diverse set of opinions. Attendees represented a wide variety of industries, included accounting, telecommunications, aerospace, financial sector, construction, biotechnological, ecommerce, and more. Further, the topics cover a wide range of subjects, and attendees expressed both supporting and dissenting opinions. However, without access to all roundtable meeting minutes, inclusion of the roundtables in formal in the test of FASB responsiveness would be incomplete.

Second, this study has limited access to discussions held by the FASB regarding revenue recognition, such as meeting minutes and staff meeting deliberations. Analyzing discussions and ideas over time is valuable not only in assessing whether or not the FASB adhered to its goal of creating principles-based standards, but also in understanding how the Board reached the standard as it current stands today. The FASB meeting minutes from 2002 until 2008 include the
dialogues and debates among attending board members. These minutes illustrate which options were presented, what various board members thought of those options, and what conclusions were reached. This documentation helps to reveal why the board made certain decisions and what reservations they held. However, in 2009, the minute-taking style changed; meeting minutes only included decisions reached. The meeting minutes that are analyzed to assess FASB responsiveness after the release of the 2008 and 2010 due-process documents do not provide substantial insight into how the FASB responded to feedback or what options were considered. Further, some meeting minutes reference handouts with explanations of components of the revenue recognition standard. While board members referred to and commented on these handouts, minutes often do not include the handouts themselves. This creates an opaque view of the basis for discussion.

This study is also limited in that it analyzes the revenue recognition project exclusively from the FASB’s point of view. Other organizations (specifically the SEC and the IASB) influenced decisions the FASB made in regards to revenue recognition. It would be helpful, for example, to also analyze trends over time in IASB meeting minutes. Perhaps comparing those minutes to FASB minutes would further illuminate why the Boards began to diverge after so firmly stating their commitment to convergence. Also, this study would benefit from the analysis of comment letters from the SEC to reporting entities regarding their interpretation of ASC 606 in their financial reports, assessing what role the SEC plays in seeing that the FASB achieves its goals.

Although this study sheds light into the efficacy of the FASB’s standard-setting process, conclusions are limited to the revenue recognition project. The scope of this study does not extend beyond the 2002 to 2017 timeline in which the creation and implementation of ASC 606
occurred; any conclusions reached in this study should only be considered within the context of this timeframe.

Finally, this study does not account for the change in FASB board members as an influential factor affecting the standard-setting process in regards to revenue recognition. The Board includes seven board members, all of whom serve a maximum of two five-year terms (FASB 2018). These board members bring different experiences, goals, and biases to the board; the introduction of new board member likely affects not only how the Board operates in meetings but also what unstated goals are pursued. The process of creating ASC 606 spanned three term periods, meaning no board member participated in the project from start to finish. Assessing to what extent the process changes as board members join and leave the FASB would provide insight into why certain decisions were made.

**FUTURE WORK**

Other research could provide even more insight into the FASB's standard-setting process in the United States. This study asks whether or not FASB stayed on track to achieve its goals of international convergence and principles-based reporting. It became clear prior to the release of ASU 2014-09 that convergence would not occur. However, given the effective implementation date will not occur until December of 2018, this study cannot look at financial statements filed with the SEC to assess whether or not the FASB successfully moved from rules to principles-based standards. The FASB had stated that it took on the revenue recognition project to address existing problems within revenue recognition guidance and to improve comparability, not only internationally but also domestically. Work should be done to compare U.S. financial statements from within and between industries to determine whether or not the FASB did promote comparable standards.
While this study suggests that the FASB adheres to its due-process in standard-setting, one might ask if the standard-setting process as it currently standards is even effective. In regard to the revenue recognition project, the FASB incorporated stakeholder feedback while still creating principles-based standards. However, interviews with Brian Schlib (KPMG), Jared Silver (KPMG) and Greg Hendler (EY) reveal that many entities are committed to reporting revenue as close to previous guidance as possible. This would mean that although the FASB released guidance for a principles-based standard, entities still report using rules-based methods. Changing internal controls and retraining the accounting team is a costly and time-consuming process; Schlib alludes that firms that truly want to avoid change have opted to adopting the standard early, filing with the SEC in hopes of receiving approval and becoming the de facto standard-setters for their respective industries. Given this hypothesis, it would be helpful to study the effect of early adopters on other filers in the industry. To do this, one would analyze the financial statements filed by early adopters, comparing these statements to previous statements from the same firm and also to others in the industry after the implementation deadline in December of 2018. Conclusions from this work would reveal both whether the FASB acts as the effective standard and also the effects of early adopters.

CONCLUSIONS

This study explores two questions in the context of the revenue recognition project: what is the influence of stakeholder input on the FASB’s standard setting process, and is the FASB able to incorporate stakeholder input without losing sight of its goals to move towards international convergence and principles-based reporting?

Using the case of performance obligations for the revenue recognition project, anecdotal evidence suggests that stakeholder input primarily helps identify areas for further clarification.
Although the FASB did not change the core of the concepts in the standard, the Board added more examples and made small modifications to alleviate stakeholder concerns. Comment letter respondents helped identify which areas the FASB needed to focus its efforts on to ensure that the standard applied to all industries and practices. In this case, it seems that the FASB responded appropriately to stakeholder feedback from comment letters; the Board takes time to consider the issues addressed, conceding or sticking to its original standard when necessary. However, even when the FASB chose not to take stakeholder suggestions, it proves that it carefully considered the matter by relaying in the subsequent due-process document what concerns were raised and by providing further explanation. These findings support the original hypothesis that the comment letter period is an effective way for constituents to express their opinion.

The FASB did not achieve its goal of making progress towards international convergence, and it is possible that it will not be able to ensure principles-based revenue recognition; however, this case study suggests that incorporation of stakeholder input did not cause this failure. Even when entities relayed industry or practice-specific concerns, the FASB maintained its overarching principles for the new standard. The Board reached out to various industries after already developing the standard, attempting to ensure operationability for all creators of financial statements. However, even when firms expressed concerns specific to themselves or doubted the need to move away from the previous method of revenue recognition, the Board provided guidance and examples without creating specific rules. Given the desire for many firms to maintain the method in which they recognize revenue and given the wide variety of guidance outside of the FASB's purview being issued, it is possible that, with SEC approval, firms will continue to create financial statements using rules-based reporting. Further, although
international convergence coincided with the solicitation of stakeholder input, the input itself did not lead to the divergence. According to Brian Schlib, a partner with KPMG who joined the FASB’s revenue recognition staff in 2012, the IASB was not interested in continuing with redeliberations after the release of the 2011 Exposure Draft. From his experience, representatives from the FASB, after assessing feedback from constituents, would have to work hard to convince the IASB that changes (either clarification or otherwise) needed to be made; he hypothesizes that the IASB did not want to shift too far from principles-based guidance, and deliberations at that point in time covered specific, rules-based issues. Schlib states that prior to the redeliberations, this project was, “...truly a joint effort.” Although the Boards moved away from convergence on this project specifically, and it might make sense to attribute the disintegration of the relationship to the nature of the conversations (i.e. principles-based versus rules-based), it is important to consider the environment in which this breakdown occurs.

After evaluating the FASB’s process for creating a new revenue recognition standard, it becomes evident that this study addresses a third question: Does the FASB adhere to “due-process” as it is described in the Rules of Procedure by adequately seeking, processing, and incorporating stakeholder feedback? Even when cooperating with other standard-setting bodies, the FASB not only actively solicited feedback, but also it thoughtfully considered and addressed concerns in the case of performance obligations. This leads to the conclusion that the FASB did indeed carefully and diligently follow the standard-setting process outlined in its Rules of Procedure.
REFERENCES


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Appendix I: FASB Rules of Procedure (Due-process)

E. Due Process

The FASB is committed to following an open, orderly process for setting standards. The FASB designed its comprehensive due process procedures, as more fully discussed below, to permit timely, thorough, and open study of financial accounting and reporting issues and to encourage broad public participation in the standards-setting process by creating channels for the communication of all points of view and expressions of opinion at all stages of the process. The cooperation of all concerned with or affected by financial accounting and reporting is fundamental to the operation of the FASB. Of particular importance to the FASB is the receipt of thoughtful, reasoned, and timely input during the FASB’s research, discussion, and deliberative processes. The FASB recognizes that acceptance of its conclusions is enhanced by demonstrating that the comments received in due process are considered carefully.

Appendix II: 2008 Discussion Paper Questions for Respondents

1. Do you agree with the Boards’ proposal to base a single revenue recognition principle on changes in an entity’s contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

2. Are there any types of contracts for which the Boards’ proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

3. Do you agree with the Boards’ definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

4. Do you think the Boards’ proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

5. Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

6. Do you think that an entity’s obligation to accept a returned good and refund the customer’s consideration is a performance obligation? Why or why not?
7. Do you think that sales incentives (for example, discounts on future sales, customer loyalty points, and “free” goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?
8. Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.
9. The Boards propose that an entity should recognize revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.
10. In the Boards’ proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.
   a. Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?
   b. Do you agree that a performance obligation should be deemed onerous and remeasured to the entity’s expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?
   c. Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.
   d. Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.
11. The Boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (for example, selling costs) are included in the initial measurement of the performance obligations. The Boards propose that an entity should recognize those costs as expenses unless they qualify for recognition as an asset in accordance with other standards.
   a. Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity’s performance obligations? Why or why not?
   b. In what cases would recognizing contract origination costs as expenses as they are incurred not provide decision-useful information about an entity’s financial position and financial performance? Please provide examples and explain why.
12. Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity’s standalone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?
13. Do you agree that if an entity does not sell a good or service separately, it should estimate the standalone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?
Appendix III: 2010 Exposure Draft Questions for Respondents

1. Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether to:
   a. combine two or more contracts and account for them as a single contract;
   b. segment a single contract and account for it as two or more contracts; and
   c. account for a contract modification as a separate contract or as part of the original contract.
   Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

2. The Boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

3. Do you think that the proposed guidance in paragraphs 25–31 and related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

4. The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price. Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?

5. Paragraph 43 proposes that the transaction price should reflect the customer’s credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer’s credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue? If not, why?

6. Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

7. Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

8. Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, Topic 330 or IAS 2; Topic 360 or IAS 16; and Topic 985 on software or IAS 38, Intangible Assets), an entity should recognize an asset only if those costs meet specified criteria. Do you think that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient? If not, why?
9. Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation. Do you agree with the costs specified? If not, what costs would you include or exclude and why?

10. The objective of the Boards’ proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

11. The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year. Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

12. Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why? Effective date and transition (paragraphs 84 and 85)

13. Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why? Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

14. The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance. Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

15. The Boards propose that an entity should distinguish between the following types of product warranties: (a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract. (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract. Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

16. The Boards propose the following if a license is not considered to be a sale of intellectual property: (a) if an entity grants a customer an exclusive license to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the license; and (b) if an entity grants a customer a nonexclusive license to use its intellectual property, it has a performance obligation to transfer the license and it satisfies that obligation when the customer is able to use and benefit from the license. Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the patterns of revenue recognition proposed by the Boards? Why or why not?
17. The Boards propose that in accounting for the gain or loss on the sale of some nonfinancial assets (for example, intangible assets and property, plant, and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

18. Should any of the proposed guidance be different for nonpublic entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?

Appendix IV: Key Terms for 2008 Discussion Paper

- Transaction price
- Contract asset
- Contract liability
- Contract
- Definition
- Performance obligation
- Contract
- Separate (in reference to performance obligation)
- Customer consideration
- Returned good / refund (compile results)
- Sales incentive
- Satisfied (in reference to performance obligation)
- Measure (performance obligation)
- Transaction price
- Onerous (performance obligation)
- Costs (associated with obtaining a contract)
- Estimates

Appendix V: Key Terms for 2010 Exposure Draft

- Warranty
- Gain / loss
- Nonpublic
- Contracts
- Segment (in regard to a contract)
- Contract modification
- Performance obligation
  - Distinct
  - Separate
  - Satisfy
- Implementation
- Guidance
- Control
- Transfer
• Consideration
  o Variable
• Credit risk
• Estimate
• Time value of money
• Transaction price
  o Allocate
• Costs
  o Obtain
  o Fulfill
  o Contract
• Asset / liability
• Disclosure
• Disaggregate (revenue)
• Retroactive (adoption)
• Transition
• License
Appendix VI: Comment Letter No. 4 (2008 Discussion Paper)

30 April 2009

Sir David Tweedie  
International Accounting Standards Board  
30 Cannon Street  
LONDON EC4M 6XH  
United Kingdom

Via “Open to comment” page on www.iasb.org

Dear Sir David

Comments on Discussion Paper Preliminary Views on Revenue Recognition in Contracts with Customers

Thank you for the opportunity to comment on the IASB discussion paper Preliminary Views on Revenue Recognition in Contracts with Customers. CPA Australia, The Institute of Chartered Accountants and the National Institute of Accountants (the Joint Accounting Bodies) have considered the above discussion paper (DP) and our comments follow.

The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government, academia throughout Australia and internationally.

General comments

Overall we support one principles-based model for revenue recognition, and consider the theory behind the proposals in the DP to be reasonable, but more work is required in relation to the control concept. We are also concerned about how these proposals are derived from conceptual framework and what the impact on the revenue recognition project will be as the conceptual framework project progresses. We acknowledge the scope limitations indicated within the DP; however, we would encourage those areas scoped out that have not been subject to a separate review, such as lessor accounting, to be reviewed as a matter of priority in light of this proposed model.

Our response to matters on which specific comment is requested is included in the attached Appendix.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au, Kerry Hicks (the Institute) at kerry.hicks@charteredaccountants.com.au or Tom Revie (NIA) at tom.revie@nia.org.au

Yours sincerely

Geoff Banks  
Chief Executive Officer  
CPA Australia Ltd

Graham Meyer  
Chief Executive Officer  
Institute of Chartered Accountants

Michael Cremo  
Chief Executive Officer  
National Institute of Accountants

Representatives of the Australian Accounting Profession
Question 4
Do you think the boards’ proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

We consider it appropriate that a performance obligation exists when an entity promises in a contract to transfer an asset (a good or service) to the customer. However, we consider that more guidance and/or illustrative examples are necessary to make clear the distinction between the entity satisfying a performance obligation in the contract (e.g., the delivery of an asset [whether it be a good or a service]) and the activities that an entity undertakes in producing those goods and services. Without further guidance and/or illustrative examples we are concerned that preparers will have difficulty in operationalising the contract-based revenue recognition model for particular industries or sectors.

Date       June 09, 2009
To         13

Question 6:
Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

Response:
We broadly agree with the principle that performance obligations should be separated on the basis of when an entity transfers the promised assets to the customer. However, as discussed in our response to question 4, some additional criteria should be met when identifying a performance obligation:

- performance obligations should not be recognised separately for assets that are incidental to the primary goods or services that the customer is seeking to acquire,
- performance obligations should be determined with reference to whether the customer would purchase the asset on a standalone basis in normal circumstances. It is our view that the recognition of revenue for assets with no standalone value to the customer is inappropriate and is likely to be misleading to users of the financial statements. Absent standalone value, revenue should not be recognised, and
- performance obligations should relate to deliverables that represent "an output of the entity’s ordinary activities". Further guidance should be provided for identifying the ordinary activities of an entity.

Revenue should only be allocated to performance obligations identified using relative standalone selling prices to the extent that the allocated revenue does not exceed the legally enforceable payments due from the customer under the terms of the contract without the delivery of future assets to the customer. Otherwise, revenue would be recognised on the basis of cash that is only expected to be received from the customer. Under current revenue recognition principles, revenue should not be recognised for payments from customers that are contingent on the delivery of future services. We believe that users of financial statements strongly appreciate and support this fact as it limits management judgement and strongly links revenue recognised in a period to cash received from the customer in that period. It is our understanding that any dissolution of revenues and cash received would be viewed negatively by users of the financial statements.
Appendix VIII: Key Terms in Order of Frequency (2008 Discussion Paper)

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Appendix IX: Key Terms in Order of Frequency (2010 Exposure Draft)

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Appendix X: FASB Meeting Minutes Regarding Performance Obligations

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<td>September 23rd, 2009</td>
<td>• “The Board decided that an option to acquire additional goods and services in a contract with a customer would be recognized as a performance obligation only if the option provides a material right to the customer that the customer would not receive without entering into that contract. An entity would account for that performance obligation by allocating to it a portion of the transaction price.”</td>
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| October 26th, 2009    | • “To implement the concepts in the Discussion Paper, an entity should allocate the transaction price to segments of a contract rather than to individual performance obligations. A segment includes one or more performance obligations for which the entity has evidence of a market—that is, evidence that a segment of the contract could be sold separately.”  
• “An entity should select a method of measuring performance that best depicts the transfer of goods and services to the customer. Acceptable methods include methods based on units of output, units of input, or the passage of time.” |
| November 18\textsuperscript{th}, 2009 | • “The Boards discussed the nature of the performance obligations in a contract in which an entity grants a customer the right to use, but not own, intellectual property of the entity, for example, a software license.”
• “The promised asset is the license. The promise to grant that license is a single performance obligation. The entity satisfies that obligation when it enables the customer to use the license and benefit from it.”
• [Regarding subsequent measurement of performance obligations] “The Boards tentatively confirmed that performance obligations in the scope of the revenue recognition standard should be remeasured after contract inception only when they are onerous.” |
| December 16\textsuperscript{th}, 2009 | • [Regarding whether all product warranties give rise to separate performance obligations as suggested in the discussion paper] “If the objective of a warranty is to provide a customer with coverage for latent defects (that is, those that exist when the asset is transferred to the customer but are not yet apparent), that warranty does not give rise to a separate performance obligation. Instead, it acknowledges the possibility that the entity has not satisfied its performance obligation to transfer the asset specified in the contract. Therefore, on the basis of all available evidence, the entity would determine at the end of the reporting period the likelihood and extent of defects in the assets it has sold to customers and, hence, the amount of unsatisfied performance obligations with respect to those assets. Consequently: a) If the entity will be required to replace defective assets, it does not recognize revenue for those assets and b) If the entity will be required to repair defective assets, it does not recognize the portion of revenue that can be attributed to components that need to be replaced in the repair process.”
• “If the objective of a warranty is to provide a customer with coverage for faults that arise after the product is transferred to the customer, that warranty gives rise to a separate performance obligation. Therefore, the entity allocates part of the transaction price to that warranty performance obligation.”
• “If the law requires an entity to pay compensation if its products cause harm or damage, that requirement does not give rise to a performance obligation. The entity accounts for such obligations in accordance with IAS 37, Provisions,” |
Appendix XI: Change of “Performance Obligation” Definition (2011 Exposure Draft)

“Definition of a performance obligation (Appendix A)
BC62. The proposed guidance distinguishes obligations to provide goods or services to a customer from other obligations by describing them as performance obligations. The notion of a performance obligation is similar to the notions of deliverables, components, or elements of a contract in existing standards. Although the notion of a performance obligation is implicit in many existing standards, the term performance obligation has not been defined previously. Therefore, in the Discussion Paper, the Boards proposed to define a performance obligation as “a promise in a contract with a customer to transfer an asset (such as a good or a service) to that customer” (paragraph 3.2).

BC63. The 2010 proposed Update proposed a similar definition of a performance obligation. However, the proposed definition in the 2010 proposed Update specified that the promise must be enforceable. Respondents to the 2010 proposed Update expressed concerns about the term enforceable because they thought that an entity should account for some promised goods or services as performance obligations even though the promise to transfer those goods or services may not be enforceable (for example, some when-and-if-available software upgrades and award credits associated with customer loyalty programs). Consequently, the Boards decided that although a contract with a customer must be enforceable, a performance obligation could arise from a promise associated with a contract if the customer has a valid expectation that the entity will transfer a good or service.8 In making that decision, the Boards noted that identifying a performance obligation based on such promises is consistent with both of the following:

(a) The core principle of the proposed Update, because an entity would account for promised goods or services that the customer reasonably expects to receive and for which the customer promises to pay
(b) The current application of U.S. GAAP and IFRSs (for example, the definition of a constructive obligation in IAS 37, Provisions, Contingent Liabilities and Contingent Assets).”

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8 Emphasis is my own.
Determining the transaction price (paragraphs 50–67)

BC127. Determining the transaction price is an important step in the revenue recognition model because the transaction price is the amount that an entity allocates to the separate performance obligations in a contract (that is, for a contract with more than one performance obligation). The transaction price is also an input to the onerous test (see paragraphs BC204–BC216).

BC128. The Boards decided to define the transaction price as the amount of consideration that an entity expects to be entitled to receive in exchange for transferring goods or services. Therefore, the objective in determining the transaction price at each reporting date is to predict the total amount of consideration that the entity will be entitled to receive from the contract.

BC129. In light of feedback on the 2010 proposed Update, the Boards clarified that the transaction price would include only amounts (including variable amounts) to which the entity has rights under the present contract. For example, the transaction price does not include estimates of consideration from (a) the future exercise of options for additional goods or services or (b) future change orders. Until the customer exercises the option or agrees to the change order, the entity does not have a right to consideration. Additionally, the Boards observed that in some industries (for example, the healthcare industry), there may be a difference between the contractually stated price for a good or service (for example, a list price) and the amount of consideration to which the entity expects to be entitled in accordance with its customary business practice of accepting a reduced amount of consideration as payment in full from customers (or a class of customers).

BC130. Determining the transaction price when a customer promises to pay a fixed amount of cash consideration will be simple. However, determining the transaction price may be more difficult in the following cases:
(a) The promised amount of consideration is variable (paragraphs BC131–BC142).
(b) The contract has a financing component that is significant to the contract (that is, time value of money, paragraphs BC143–BC156).
(c) The promised amount of consideration is in a form other than cash (that is, noncash consideration, paragraphs BC157–BC158).
(d) There is consideration payable to the customer (paragraphs BC159–BC162).

Appendix XIII: Changes/Clarifications in Identifying Separate Performance Obligations (2011 Exposure Draft)

Identifying separate performance obligations (paragraphs 23–30)

BC67. Contracts with customers can contain many performance obligations. In the Discussion Paper, the Boards proposed that an entity should refer to the timing of the transfer of the promised goods or services to identify the performance obligations that it should account for separately. Respondents to the Discussion Paper were concerned that this proposal would require an entity to account separately for every promised good or service in a contract that is transferred at a different time, which would not be practical for many
contracts, especially for long-term services and construction contracts. Consequently, in developing both the 2010 proposed Update and this proposed Update, the Boards’ intention was to develop clear guidance that would result in an entity identifying separate performance obligations in a way that would be both practical and result in a pattern of revenue recognition that faithfully depicts the transfer of goods or services to the customer.

BC68. During outreach activities on the Discussion Paper and on the 2010 proposed Update, the Boards observed that, for many contracts, it is intuitive for an entity to identify the promised goods or services that the entity should account for separately. Consequently, the Boards wanted to develop a principle for identifying separate performance obligations that would be intuitive when applied across the various industries and transactions in the scope of the proposed guidance. That principle is the notion of a good or service that is distinct. The term distinct, in an ordinary sense, suggests something that is different, separate, or dissimilar. However, to avoid the significant diversity in practice that could result from the proposed guidance relying too heavily on the judgment of an entity about whether a good or service is distinct, the Boards decided to specify when a good or service is distinct.

BC69. In the 2010 proposed Update, the Boards proposed that a good or service is distinct if it is sold separately (by the entity or by another entity) or if it could be sold separately. The Boards were concerned that requiring an entity to account separately (and estimate a standalone selling price) for a good or service that is not capable of being sold separately might result in information that would not be useful to users of financial statements. The Boards specified in the 2010 proposed Update that a good or service must have both of the following attributes to be capable of being sold separately:

(a) A distinct function (that is, the good or service must have utility either on its own or together with other goods or services that the customer has acquired from the entity or that are sold separately by the entity or another entity)

(b) A distinct profit margin (that is, the good or service must be subject to distinct risks and the entity must be able to separately identify the resources needed to provide the good or service).

BC70. A majority of respondents to the 2010 proposed Update agreed with using the principle of “distinct” to identify the separate performance obligations in a contract. However, many respondents were still concerned that applying the criteria for determining when a good or service is distinct would not be practical and would result in an entity unbundling a contract into components that are identified without considering the economics of the transaction. Those concerns related mainly to the proposal that a good or service is distinct if it is sold separately by the entity or by another entity. Some respondents commented that the experience of other entities, including entities that operate in other markets or other jurisdictions, could be costly to obtain and would not be relevant for determining whether an entity should account separately for a promised good or service. In addition, respondents were concerned that many construction- and production-type contracts would be accounted for as many separate performance obligations because each component of the contract is sold separately (for example, by a subcontractor or by a supplier of building materials). Respondents thought that not only would it be impractical for an entity to account for those types of contracts as consisting of many performance obligations, but doing so would not reflect the economics of those transactions because
the promised goods or services are highly interrelated and interdependent (that is, each good or service in the bundle is not distinct).

BC71. Respondents to the 2010 proposed Update also raised some concerns about the use of distinct function and distinct profit margin as attributes of a distinct good or service. Respondents requested additional guidance on the meaning of distinct function because they considered that almost any element of a contract could have utility in combination with other goods or services. Respondents also found the distinct profit margin criterion to be confusing for the following reasons:

(a) Entities may decide to assign the same margin to various goods or services even though those goods or services use different resources and are subject to different risks.
(b) For some goods or services, especially for software and other types of intellectual property, cost is not a significant factor in determining price and, therefore, margins could be highly variable because they may be determined by the customer’s ability to pay or to obtain substitute goods or services from another entity.

BC72. In the proposed Update, the Boards affirmed their 2010 proposal that an entity should identify the separate performance obligations in a contract on the basis of whether a promised good or service is distinct. However, in response to the feedback on the 2010 proposed Update, the Boards refined the criteria for determining when a good or service is distinct by specifying:

(a) The attributes that all goods or services must possess to be capable of being distinct (see paragraph 28)
(b) The attributes of goods or services that when promised together (that is, as a bundle) are not distinct, even if the individual goods or services otherwise would meet the criteria in paragraph 28 (see paragraph 29).