



**International  
Accounting Standards  
Board**

**30 Cannon Street, London EC4M 6XH, United Kingdom**  
**Phone: +44 (0)20 7246 6410, Fax: +44 (0)20 7246 6411**  
**Email: [iasb@iasb.org](mailto:iasb@iasb.org) Website: <http://www.iasb.org>**

*This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.*

*These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.*

## **INFORMATION FOR OBSERVERS**

**Board Meeting: 25 April 2006, London**

**Project: Revenue Recognition (Agenda Paper 5)**  
(This observer note is also issued for Agenda Paper 3 at the Joint IASB/FASB Meeting)

---

## **Additional Alternatives for Revenue Recognition**

### **OBJECTIVE OF THE MEMO**

1. At the March 22, 2006 FASB education session and the March 30, 2006 IASB Board meeting, the Boards directed the staff to consider whether there is a method of recognizing revenue based on a single, conceptual foundation that results in EBM-like accounting for short-term contracts and PBM-like accounting for long-term contracts. This memo addresses that request.
2. Board members also made a number of observations at those meetings, including:
  - a. Some Board members observed that the EBM is based on a customer perspective. Thus, the EBM is consistent with prior Board decisions on initial measurement (allocated customer consideration amount) and the disaggregation of contracts into separate units of account because those decisions are also based on the customer's perspective. Those Board members argue that the customer perspective should be used consistently throughout as a basis for revenue recognition to maintain internal consistency of any eventual standard.
  - b. Other Board members observed that using the customer perspective was the result of a compromise between Board members who supported a fair value approach to revenue recognition and those who did not. Those Board members argue that decisions based on a compromise should not constrain decisions on other issues (especially if relevance and faithful representation are at issue).
  - c. Board members generally support the idea that for long-term contracts, complete delivery of a good should not be a necessary condition for revenue recognition. That is, revenue could be recognized when a reporting entity has made progress towards performing a contractual obligation but has not completed performance.

- d. Some Board members disagreed with the staff's interpretation of *customer utility* as an all-or-nothing concept (that is, the customer can have utility only for a fully constructed good). Those Board members argued that the notion of *customer utility* should be broad enough to include the idea that, for example, a partially constructed good has utility to the customer and, therefore, would be a sufficient basis on which to recognize revenue.
- e. Other Board members asked whether the notion of customer acceptance could be integrated with the PBM (presumably as a form of external progress validation).

## **FINDING A CONCEPTUAL MIDDLE GROUND BETWEEN EBM AND PBM**

5. Finding a conceptual middle ground between the EBM and PBM has proven difficult. That difficulty results mainly in the mutual exclusivity of the reporting entity perspective and the customer perspective. The reporting entity perspective is based on acts of the reporting entity (or the production process) that ultimately will result in the satisfaction of a contractual obligation to the customer. The customer perspective is based on either (a) the receipt of goods, services, or other rights or (b) the receipt of other types of benefits (such as accepting progress to date in the construction of an asset). Thus, the timing of the reporting entity's efforts may or may not coincide with the timing of delivery or customer acceptance (or other critical events for revenue recognition under the customer perspective). ....

6. The staff also considered whether a *contract perspective* or a *rights-to-consideration* notion could be used to bridge the gap between EBM and PBM.

### **Contract Perspective**

7. A contract perspective is based on the specific terms of an individual contract. Because the contract specifies the goods, services, or other rights to be delivered to a customer (or the customer acceptance points in long-term contracts), a contract perspective appears in all practical respects to be a form of customer perspective. Furthermore, contracts generally do not state how the goods will be constructed or provided (that is, how the production process will be carried out). To illustrate, consider a contract to provide an aircraft. In general, the contract will not describe all the steps necessary to construct the aircraft; rather it will only specify the overall requirement to provide it.

### **Rights to Consideration Perspective**

11. The staff also considered a rights-to-consideration notion as reflected in the U.K. ASB's Amendment to FRS 5, *Reporting the Substance of Transactions: Revenue Recognition*, (referred to as Application Note G). The staff concluded that a rights-to-consideration model is the equivalent of an EBM in the sense that performance (which results in the reporting entity obtaining a right to consideration) is defined in Application Note G as "the fulfilment of the seller's contractual obligations to a customer through the supply of goods and services." Thus, the staff would argue that a rights-to-consideration notion is merely another way of describing a customer-perspective-based model like the EBM.

### **Other Alternatives**

12. Those analyses have led the staff to conclude that any revenue recognition method necessarily would represent either a reporting-entity perspective or a customer perspective. Thus, those are the two platforms on which a revenue recognition method can be based. Given the Boards' directives at the last meetings and the staff's conclusion, this memo presents, in addition to the EBM and PBM, three additional alternatives for the Boards' consideration:

**Alternative 1: EBM**

**Alternative 2: EBM with an exception for long-term contracts**

**Alternative 3: Customer Benefit Method**

**Alternative 4: PBM with application accommodations**

**Alternative 5: PBM**

13. For convenience, the appendix to this memo provides a summary of the EBM and PBM as previously proposed by the staff.

**REVENUE RECOGNITION METHODS**

**Alternative 2: EBM with an Exception for Long-Term Contracts**

14. This alternative uses the EBM as a platform but provides an exception for long-term contracts. This alternative is very much like current practice internationally and in the U.S. Current practice for long-term contracts uses IAS 11, *Construction Contracts*, and AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, as separate standards with their own set of principles that conflict with other revenue recognition guidance such as IAS 18, *Revenue*, for goods and U.S. SEC Staff Accounting Bulletin 104, *Revenue Recognition*.

15. This alternative acknowledges that any method that requires the complete delivery of a good as a necessary condition for revenue recognition for short term contracts cannot be consistent with a method that does not require the complete delivery of a good as a necessary condition for revenue recognition for long term contracts. In principle, a contract's short- or long-term nature is irrelevant to revenue recognition. Therefore, one is left with a contradiction in principle—either complete delivery of a good is a necessary condition for revenue recognition or it is not.

16. In light of that contradiction, this alternative provides for an exception to the EBM principle on grounds of relevance and faithful representation. Said differently, an exception is supportable because financial statements of reporting entities with long-term contracts provide more decision-useful information if they reflect economic activity occurring prior to the delivery of a completed good.

**Alternative 3: Customer Benefit Method**

18. The customer benefit method (CBM) is based on the customer perspective. However, it is not like the EBM. The EBM's underlying premise is based on the timing of a performance obligation's legal extinguishment. Extinguishment is 'all-or-nothing'; a unit of account cannot be partially extinguished. The EBM uses an accounting proxy that represents the approximate point of legal extinguishment; that is, when the customer obtains the right to use or benefit from the goods, services, or other rights. On the other hand, the CBM's underlying premise is as follows:

**Revenue is recognized when performance occurs and, thereby, results in partial or full extinguishment of an obligation to provide goods, services, or other rights to customers. Performance is deemed to occur when the customer receives benefits.**

19. In its broadest sense, a benefit is any advantage that the customer receives vis-à-vis others as a result of acts performed by the reporting entity. However, the staff thinks that this meaning is unmanageable for accounting purposes because it is too broad. In a narrowed form, a benefit represents any progress made by the reporting entity in constructing or providing a good, service, or other right to the customer that can be validated by the customer. Delivering the good, service, or other right always conveys benefits to the

customer. Thus, we could specify that a customer receives benefits when both of the following conditions are satisfied:

- (a) The good, service, or other right has been provided or partially completed, and
- (b)(i) The customer has accepted performance to date (unless acceptance is perfunctory) or (ii) the customer is obligated to accept performance to date (that is, the contract's legal remedy for breach is or is like specific performance or in the event of customer cancellation, the customer is obligated to pay damages reflecting performance to date).

20. The staff thinks that if customer acceptance is perfunctory, revenue recognition should not be delayed until that acceptance occurs because it is not substantive. If a contract is being performed according to specification, customer acceptance is presumed to be perfunctory if the seller has a history of successfully performing on contracts for identical or similar goods, services, or other rights. ...

21. The staff notes that there may be various views on the meaning of *acceptance*. For example, one might argue that acceptance only corresponds to the customer's approval of performance to date (that is, the customer agrees that performance is consistent with the contract), which is consistent with the notion described in paragraph 19(b)(i). Alternatively, acceptance could correspond only to when the reporting entity has an unconditional right to a portion of the contract consideration amount (that is, that a portion of the consideration cannot be recovered later by the customer if the reporting entity fails to complete a subsequent stage of the contract), which is consistent with the notion described in paragraph 19(b)(ii). Currently, criterion 19(b) encompasses both those views. If Board members prefer some other interpretation of customer acceptance, the staff can explore one.

22. Under contracts that convey benefits to the customer over a period of time, the entity would recognize revenue over that time period. The CBM would require reporting entities to determine how and when benefits are transferred to customers; that determination is similar to the determination that a reporting entity would make under the PBM to reflect the acts in its production process. However, the measure of how those benefits are transferred, unlike the measure of performance under the PBM, is determined from the customer's perspective and relates back to what is specified in the contract.

23. Under contracts that convey benefits to the customer in a short period of time (e.g., retail sales) revenue would be recognized when the customer obtains the goods, services, or other rights; that is, benefits are conveyed to the customer at a single moment in time.

#### **Alternative 4: PBM with Application Accommodations**

25. The PBM with application accommodations modifies the PBM to accommodate short-term contracts and imposes customer validation of the production process as a necessary condition for revenue recognition. The staff refers to those modifications as "accommodations" because they do not violate the underlying premise of the PBM; that is, value creation occurs throughout the production process, resulting in increases in assets.

26. The first accommodation applies to short-term contracts. Because the PBM yields results that are substantially similar to those of the EBM for short-term contracts, the staff thinks that a presumption could be included in the revenue recognition standard. That presumption might take the following form:

For short-term contracts, the PBM is presumed to yield results that are substantially similar to the EBM, and, therefore, the (less-costly) EBM shall be used for those contracts.

27. This presumption means that reporting entities with short-term contracts would recognize revenue much like they always have under existing accounting guidance. The key issue with this presumption is whether and, if so, in what form to provide guidance on the meaning of *short-term contract*. ...

29. The second accommodation applies to long-term contracts. The staff has sensed that some Board members are concerned with the possibility that the PBM may be abused because it focuses solely on the reporting entity's production process and the reporting entity may be able to manipulate that process to achieve desired revenue recognition. To address that concern, the Boards could overlay a customer acceptance criterion onto the PBM. That criterion is designed to impose discipline on a reporting entity in determining progress to date. That criterion could be similar to that described above in the CBM:

Revenue shall be recognized if (a) the customer has accepted performance to date (unless acceptance is perfunctory) or (b) the customer is obligated to accept performance to date (that is, the contract's legal remedy for breach is or is like specific performance or in the event of customer cancellation, the customer is obligated to pay damages reflecting performance to date).

30. The overlay of customer acceptance would require an external validation on the reporting entity's production process as a condition for revenue recognition. Therefore, it imposes a form of customer perspective on top of the PBM but leaves unaffected the PBM's underlying concept. In other words, it imposes an output measure of performance, because performance has to be validated by the customer's explicit or implicit acceptance. Similar to Alternative 3, that performance relates back to what is specified in the contract. ....

## **APPLYING THE ALTERNATIVES**

31. This section uses several examples to illustrate how the different alternatives would be applied.

### **Example A — Tangible Asset**

Seller contracts with the customer to construct a tangible asset for €5,000,000. Construction takes place over two annual periods. At completion, the customer will pick up the completed asset. This is not a multiple-element contract.

There are two progress payments of 30 percent of the contract price that are each due at stage completion points (conditional upon customer acceptance of progress to date). One final payment of 40 percent of the contract price is due when construction is complete (also conditional upon customer acceptance of the final product).

In the event of the customer's cancellation, the customer will pay all the seller's out-of-pocket costs incurred to date plus a normal profit margin thereon. Under this clause, the customer also obtains all legal rights to the partially completed asset.

### ***Alternative 1: EBM***

32. The customer does not obtain the tangible asset until construction is complete and the customer inspects and accepts it. That is because the customer has contracted for a completed tangible asset and the customer has not received a right to use or otherwise benefit from it until final acceptance. Therefore, the performance obligation is deemed to be extinguished and, thus, revenue is recognized only upon customer acceptance of the completed asset.

### ***Alternative 2: EBM with LTC exception***

33. Revenue recognition is identical to the PBM (Alternative 5, paragraph 36). That is, revenue is recognized over the production period based on the performance measure that the seller chooses to faithfully represent its production process.

***Alternative 3: CBM***

34. Revenue is recognized as benefits are conveyed to the customer over the contract period because the customer is obligated to accept performance to date (in the event of customer cancellation, the customer is required to pay all out-of-pocket costs incurred by the seller plus a normal profit margin thereon). The reporting entity will have to determine how to measure the benefits that are conveyed to the customer over the contract period. That determination is similar to the determination that a reporting entity would have to make under the PBM. However, the CBM is different from the PBM because the CBM is based on the customer's perspective.

***Alternative 4: PBM with application accommodations***

35. Revenue recognition is identical to the PBM (Alternative 5, paragraph 36) because the customer is obligated to accept performance to date (in the event of customer cancellation, the customer will pay all the seller's out-of-pocket costs incurred to date plus a normal profit margin thereon). Revenue is recognized over the production period based on the performance measure that the seller chooses to faithfully represent its production process.

***Alternative 5: Performance-based method (PBM)***

36. The seller must choose a performance measure that faithfully represents its production process and use it consistently. It may decide to use an output- or input-based method. For this example, the staff assumes that the seller uses an input method based on costs incurred. Thus, the production process creates or enhances assets for customers, and thus revenue is recognized, based on the input method.

37. If Example A's facts were changed to eliminate the customer cancellation provision, then Alternatives 3 and 4 would be different from Alternatives 2 and 5. That is because, assuming that customer acceptance is not perfunctory, revenue recognition would depend on the timing of the customer's acceptance. Still further, if the facts were changed to eliminate partial customer acceptance (and customer acceptance was not perfunctory), then Alternatives 1, 3, and 4 would yield the same results.

**Example B — Audit Service**

Seller contracts with the customer to provide an annual financial statement audit for \$40,000. Audit procedures will occur throughout the year subject to audit and the audit opinion must be available by the end of February of the subsequent year.

In the event of customer cancellation, the customer will pay all out-of-pocket costs incurred by the seller plus a normal profit margin thereon. This is not a multiple-element contract.

***Alternative 1: EBM***

38. The customer does not obtain benefit from the audit until the audit opinion is submitted to the customer. The performance obligation is extinguished and, thus, revenue is recognized, only when the audit opinion is submitted to the customer.

***Alternative 2: EBM with LTC exception***

39. Revenue recognition is identical to the PBM (Alternative 5, paragraph 42); that is, revenue is recognized over the production (service) period based on the performance measure that the seller chooses to faithfully represent that production process.

### ***Alternative 3: CBM***

40. Revenue is recognized as benefits are conveyed to the customer over the contract period because the customer is obligated to accept performance to date (in the event of customer cancellation, the customer is required to pay all out-of-pocket costs incurred by the seller plus a normal profit margin thereon). The reporting entity will have to determine how to measure the benefits that are conveyed to the customer over the contract period (similar to what must be done under the PBM).

### ***Alternative 4: PBM with application accommodations***

41. In the event of breach, the customer is obligated to pay all out-of-pocket costs incurred by the seller plus a normal profit margin thereon; therefore, the customer is obligated to accept performance to date. Revenue recognition is identical to the PBM (Alternative 5, paragraph 42).

### ***Alternative 5: PBM***

42. The seller must choose a performance measure that faithfully represents its production process. The seller's production process may be measured using an input method based on costs incurred or labor hours expended. Revenue is recognized based on that input method.

43. If Example B's facts were changed to eliminate the customer cancellation provision, then Alternatives 3 and 4 would be different from Alternatives 2 and 5. That is because, assuming that customer acceptance is not perfunctory, revenue recognition would depend on the timing of the customer's acceptance.

## **Example C — Retail Transaction**

Retailer sells high-quality power tools and offers a lifetime warranty and 60-day return right. Historically, returns have been less than 3% of sales. Retailer has its own delivery truck and makes its deliveries itself.

On the same day, three customers each purchase a large drill press out of inventory. Each drill press sells for £1,000.

The first customer pays for the drill press and takes it home.

The second customer pays for the drill press and asks the retailer to hold it in storage until Saturday when she will pick it up. Retailer's insurance covers any property loss that might occur to the drill press prior to customer pick-up.

The third customer pays for the drill press and pays £50 extra for delivery. Delivery of the drill press is scheduled for the same Saturday on which the second customer will pick up her drill press. Retailer's insurance covers any property losses that might occur to the drill press prior to delivery to the customer's location.

### ***Alternative 1: EBM***

44. The key issue is determining when the customer obtains the right to use or benefit from the drill press because that is the point at which the performance obligation is deemed to be extinguished. Thus, extinguishment occurs when the asset, which is the thing being sold, is transferred from the reporting entity to the customer. That is when the asset is derecognized by the reporting entity and simultaneously recognized by the customer.

45. Some staff members think that the three customers obtain the assets at the point of sale. Therefore, revenue would be recognized for the drill presses at the time of sale.

However, other staff members assert that Customers 2 and 3 do not have assets until the drill presses have been picked up or delivered to them because the customer cannot actually use the presses until then (and the customers are not exposed to risk of loss from fire, theft, etc.).

....

46. The warranty and return right are both continuous services that provide the customer with benefits over time. Revenue is recognized over their respective contractual periods.

47. Revenue for the delivery service would be recognized when the drill press is delivered to the customer's location and the seller extinguishes its delivery obligation.

***Alternative 2: EBM with LTC Exception***

48. Revenue recognition for the drill presses, warranty, return right, and delivery is identical to the EBM (Alternative 1, paragraphs 44-47), which is identical to the PBM (Alternative 5, paragraphs 51-53).

***Alternative 3: CBM***

49. Revenue recognition for the drill presses, warranty, return right, and delivery is identical to the EBM (Alternative 1, paragraphs 44-47), which is identical to the PBM (Alternative 5, paragraphs 51-53).

***Alternative 4: PBM with Application Accommodations***

50. Revenue recognition for the drill presses, warranty, return right, and delivery would be identical to the EBM (Alternative 1, paragraphs 44-47), which is identical to the PBM (Alternative 5, paragraphs 51-53).

***Alternative 5: PBM***

51. The retailer would measure performance based on units sold to customers. For retailers, the production process consists mostly in adding time and place value (i.e., making goods available to customers when they need the goods and where they need the goods). For retailers that hold inventory, most of the time and place value is generally added shortly before the existence of a customer contract. In addition, most retail contracts are short-term. For that reason, an output-based method and an input-based method would provide similar results. In this case, an output-based method based on units sold would seem easier to apply because it is based on units rather than costs. In this case, revenue for the drill presses is recognized at the point of sale (identical to the EBM—Alternative 1, paragraph 44).

52. The warranty and return right are both continuous services that provide the customer with benefits over time. Revenue is recognized over the respective contractual period (identical to the EBM—Alternative 1, paragraph 46).

53. Given that deliveries in this example would be local and completed on the same day, revenue for the delivery is recognized in practice when the drill press is delivered to the third customer's location (identical to the EBM—Alternative 1, paragraph 47).

**A Variant on Example C**

54. In Memo 81, the staff presented a variant to this retail example. That variant assumed that the retailer only had two drill presses in inventory. Thus, Customers 1 and 2 are allocated a drill press and Customer 3 must wait for another drill press to arrive at the retailer's location.

55. Consequently, no revenue should be recognized for Customer 3 at the time of sale under the EBM and PBM. Assuming that the good is delivered to the retailer rather than directly to the customer, some staff members think that revenue should be recognized under both the EBM and PBM when the good arrives at the retailer's location and is found by the retailer to conform to product specifications. It is at this point that the retailer would have an



asset (i.e., inventory) that would be transferred immediately to the customer because of the contract. Other staff members assert that revenue should be recognized under the EBM and PBM when the drill press has been delivered to the customer. Using the other alternatives does not change the main issue in this case, which is determining when the customer has an asset.

#### **Example D — Mortgage Origination Fee and Mortgage Loan**

A mortgage lender provides residential mortgage loans at competitive rates (based on the market interest rate prevailing when the loan is funded). Applicants are required to pay a 0.25 percent origination fee when they submit their applications. These fees are completely non-refundable, even if a loan application is not approved.

A would-be borrower submits an application for a \$100,000 loan and pays the required \$250 fee.

The mortgage lender approves the borrower's application and provides the \$100,000 to the customer at the prevailing market interest rate.

For the purposes of this example, this is not a multiple element contract; that is, the loan origination services do not meet the criteria to be considered a separate unit of account.<sup>1</sup>

##### ***Alternative 1: EBM***

56. The bank extinguishes part of its obligation to the customer each day the customer has use of the money because the customer has the right to use that money each day. Therefore, the bank would recognize interest revenue and the loan origination fee over the life of the loan (identical to the PBM and current practice under FASB Statement No. 91, *Accounting for Nonrefundable Fees ...*).

##### ***Alternative 2: EBM with LTC exception***

57. Revenue recognition is identical to the EBM (Alternative 1, paragraph 56), which is identical to the PBM (Alternative 5, paragraph 60).

##### ***Alternative 3: CBM***

58. Revenue is recognized as benefits are conveyed to the customer over the contract period. The reporting entity will have to determine how to measure the benefits that are conveyed to the customer over the contract period; however, the staff thinks that the revenue recognition should be identical to the EBM (Alternative 1, paragraph 56), which is identical to the PBM (Alternative 5, paragraph 60).

##### ***Alternative 4: PBM with application accommodations***

59. Revenue recognition is identical to the EBM (Alternative 1, paragraph 56), which is identical to the PBM (Alternative 5, paragraph 60).

##### ***Alternative 5: PBM***

60. The seller must choose a performance measure that faithfully represents its production process and use it consistently. In this example, the production process would reflect the

---

<sup>1</sup> This example last was discussed by the Boards at their October 24, 2005 joint meeting. At that meeting, the Boards noted that nonrefundable, upfront fees (such as loan origination fees) that are paid to access another service or right needed to be considered further. The Boards did not reach a conclusion on whether a nonrefundable, upfront fee should be a separate unit of account from the customer's perspective. Therefore, because the issue of unit of account is outside of the scope of this memo, the staff has assumed that there is a single unit of account.

provision of the right to use the bank's capital over the life of the loan; thus, the bank would recognize interest revenue and the loan origination fee over the life of the loan (identical to the EBM).

#### **STAFF RECOMMENDATION**

61. Consistent with the recommendation in Memos 79 and 81, the staff continue to support the PBM. However, the staff does not think that a Board decision to use the PBM as its conceptual base would preclude use of other methods as default mechanisms or cost-effective practical expedients, such as using EBM for short-term contracts that do not span accounting periods. For that reason, of the three new alternatives presented in this memo, the staff prefers Alternative 4.

**Discussion Question: Which method for revenue recognition do the Boards want the staff to more fully develop?**

## APPENDIX

### SUMMARY OF THE EXTINGUISHMENT-BASED METHOD (EBM) AND THE PERFORMANCE-BASED METHOD (PBM)

62. For convenience, this appendix summarizes the EBM and PBM as proposed by the staff.

#### EBM

63. The EBM is based on the following proposition:

**An obligation to provide goods, services, or other rights to customers is extinguished (and, therefore, revenue arises) only when it is legally extinguished.**

64. Thus, the objective is to recognize revenue when the obligation to provide goods, services, or other rights is legally extinguished. However, that objective must be modified because the staff does not think that a literal interpretation of that proposition is a viable alternative for a revenue recognition method. That is because the complexity associated with multiple legal jurisdictions and multiple laws (common law versus statutory law) results in inconsistent legal outcomes for similar economic transactions. Furthermore, that complexity creates uncertainty about when particular performance obligations would be regarded as *legally* extinguished. Consequently, the objective of the EBM is to recognize revenue *at the approximate time* when the obligation to provide goods, services, or other rights is legally extinguished. Thus, revenue recognition is based on an accounting proxy for legal extinguishment.

65. The staff thinks that the best accounting proxy for legal extinguishment is the point in time at which the customer obtains the goods, services, or other rights (because, assuming the items meet the customer's specifications, the reporting entity has no further obligation with respect to the items). **The customer obtains the goods, services, or other rights when the customer obtains the right to use or benefit from the goods, services, or other rights.** The customer generally obtains goods when they are physically transferred to it because that is when the customer obtains the right to use or benefit from the goods. The customer generally obtains services when they are rendered because that is when the customer obtains the right to use or benefit from them.

#### PBM

66. The PBM is a proportionate-performance method. As opposed to the EBM, in which performance is deemed to occur in a single act (when goods or services are obtained), under the PBM performance includes all acts in the production process. (The term *production process* is used with the same meaning described in Concepts Statement No. 6, *Elements of Financial Statements*; that is, it includes "not only manufacturing and other conversion processes but also other productive activities such as storing, transporting, lending, insuring, and providing professional services that might be overlooked if *producing* were narrowly equated with *manufacturing*."<sup>2</sup>) In principle, all acts in the production process are carried out to fulfill a contractual obligation and are economic events that give rise to revenue. Revenue arises because each act in the production process gives rise to an asset or enhances an existing asset. Hence, the PBM is based on the following proposition:

**The production process creates or enhances assets for customers and, therefore, gives rise to revenue.**

67. Consequently, the objective of the PBM is to recognize revenue as the production process occurs. **In revenue contracts, the production process occurs when the reporting**

---

<sup>2</sup> See paragraph 74, footnote 38 of Concepts Statement 6.

**entity carries out acts to fulfill its contractual obligation to provide goods, services, or other rights to the customer.** A reporting entity using the PBM would determine when acts have occurred that faithfully reflect performance in the production process. Those acts of performance may be reflected by outputs from the production process, inputs to the production process, the passage of time, or the reduction of risk.