Project	**Revenue Recognition**
Topic	**Cost guidance associated with contracts with customers – supplement to Appendix A**

Purpose

1. At the November 11, 2009 education session, FASB members requested further clarification about the cost guidance listed in Appendix A to Agenda Paper 6D/Memo 123D. This paper has been prepared in response to that request.

2. This paper:

   (a) Summarizes and analyses the cost guidance included in existing revenue standards (i.e. ASC Subtopic 605 *Revenue*; IAS 11 *Construction Contracts*; and IAS 18 *Revenue*), and

   (b) Explains the effects on that guidance of the Boards' tentative decision to expense all costs unless eligible for capitalization in accordance with other standards (e.g. inventory; property, plant and equipment; intangible assets, and software).

Analysis

3. Table A below lists the cost guidance contained in existing revenue standards and indicates whether the guidance provided by those standards relates to:

   (a) capitalizing costs;

   (b) expensing costs when incurred;

(c) the application of the percentage-of-completion method or the matching of revenues and expenses; or

(d) the presentation of revenues and costs on a gross or net basis.

4. The Boards' decision in the discussion paper is to recognize costs as expenses when incurred unless they are eligible for capitalization in accordance with other standards. That decision would potentially affect the accounting for costs in the 'capitalize' category (i.e. the costs that at present are capitalized) in Table A. Accordingly, Table B further analyses that capitalization guidance to evaluate the potential effects if that guidance is withdrawn.

5. The Boards' decision in the discussion paper will not directly affect existing practices based on the other categories of cost guidance listed in Table A. This is because that guidance either explains that costs should be expensed, addresses presentation, or describes when revenue should be recognized in relation to the related costs.

6. Based on Table B, the staff thinks that the effect of the Boards' tentative decisions in the discussion paper is that:

   (a) contract origination costs—if they are currently eligible for capitalization—would be recognized as expenses when incurred.

   (b) pre-contract costs would be recognized as expenses when incurred unless they meet the cost capitalization criteria in other standards (e.g. inventory; property, plant and equipment; intangible assets; and software).

7. The staff thinks that many of the contract costs (other than origination costs) that are capitalized in Table B would meet the capitalization criteria in other standards such as inventory under IAS 2 *Inventory* and ASC Topic 330 *Inventory*.

Table A: Types of cost guidance in existing revenue standards

Standard	Capitalize	Expense	POC	Presentation
ASC Subtopic 605-20 Services (Separately Priced Extended Warranty and Product Maintenance Contracts)	X	X	X	
ASC Subtopic 605-20 Services (Fees for guaranteeing a loan)			X	
ASC Subtopic 605-35 Construction-Type and Production-Type Contracts	X	X	X	
IAS 11 Construction Contracts	X	X	X	
ASC Subtopic 605-45 Principal Agent Considerations				X
ASC Subtopic 912-605 Contractors – Federal Government		X	X	
ASC Subtopic 922-605 Entertainment – Cable Television			X	
ASC Subtopic 924-605 Entertainment – Casinos				X
ASC Subtopic 926-605 Entertainment – Films		X		
IAS 18 Revenue	X			
ASC Subtopic 944-605 Financial Services – Insurance		X	X	
ASC Subtopic 946-605 Financial Services – Investment Companies		X	X	X
ASC Subtopic 948-605 Financial Services – Mortgage Banking			X	
ASC Subtopic 952-605 Franchisors			X	
ASC Subtopic 958-605 Not-For Profit Entities			X	
ASC Subtopic 970-605 Real Estate – General		X	X	
ASC Subtopic 976-605 Real Estate – Retail Land			X	
ASC Subtopic 978-605 Real Estate –Time Sharing Activities			X	
ASC Subtopic 985-605 Software			X	

Table B: Types of costs that can be capitalized in accordance with existing revenue standards

		Staff's view on the nature of the costs that are eligible for capitalization under existing revenue standards			
Standard	**Capitalization Guidance**	**Origination costs**	**Inventory**	**PP&E**	**Intangible**
ASC Subtopic 605-20	**Services- Separately Priced Extended Warranty and Product Maintenance Contracts**: Costs that are directly related to the acquisition of a contract and that would have not been incurred but for the acquisition of that contract (incremental direct acquisition costs) are deferred and amortized in proportion to the revenue recognized.	**X**			
ASC Subtopic 605-35	**Construction-Type and Production-Type Contracts:** Contract costs: Costs related to production (includes all direct costs – materials, direct labor, subcontractors, and indirect costs identifiable with or allocable to the contract).		**X**		
ASC Subtopic 605-35	**Construction-Type and Production-Type Contracts:** Pre-contract costs: Costs incurred in anticipation of a future contract are capitalized if they can be directly associated with a specific anticipated contract and if their recoverability from that contract is probable.		**X**	**X**	**X**
IAS 11	**Construction Contracts** Contract costs: A contractor may have incurred costs that relate to future activity on the contract. Such costs are recognized as an asset provided it is probable that they will be recovered. Such costs represent an amount due from the customer and are often classified as contract work-in-		**X**		**X**

	process.				
IAS 11	**Construction Contracts** Pre-contract costs: The types of pre-contract costs that typically would qualify to be capitalized are the direct costs associated with a contract bid (e.g. design, legal and consultancy fees, and costs of preparing and printing the bid documentation).		**X**		**X**
IAS 18	**Revenue** Transaction costs associated with: 1) Creating or acquiring a financial asset other than one that under IFRS 9 *Financial Instruments* is measured at fair value through profit or loss 2) Loan commitments outside the scope of IAS 39 *Financial Instruments: Recognition and Measurement* 3) Issuing financial liabilities measured at amortized cost are deferred and recognized as an adjustment to the effective interest rate. Incremental costs that are directly attributable to securing an investment management contract are recognized as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. The asset represents the entity’s contractual right to benefit from providing investment management services, and is amortized as the entity recognizes the related revenue.	**X**			