IASB/FASB Meeting
Week commencing 16 May, 2011

IASB Agenda reference 4B

Staff Paper

FASB Education Session
May 11, 2011

FASB Agenda reference 143B

Project	**Revenue from Contracts with Customers**
Topic	**Disclosures about assets from acquisition and fulfillment costs**

Introduction and purpose

1. This paper considers disclosures about assets arising from the costs that an entity incurs to acquire and fulfill a contract with a customer.

Staff recommendations

2. The staff recommends that the Boards require an entity to disclose the following information about an asset arising from the costs of *acquiring* a contract with a customer for each reporting period:

   (a) The nature and amount recognized as an asset arising from the cost incurred to acquire a contract with a customer as of the end of the reporting period.

   (b) The amount recognized as an expense on satisfaction of the performance obligation during the period and method used to determine that amount.

3. The staff recommends that the Boards require an entity to disclose the following information about an asset arising from the costs of *fulfilling* a contract with a customer for each reporting period:

(a) A reconciliation of the carrying amount of the major classifications (e.g. precontract design costs, setup costs) of assets arising from the costs of fulfilling a contract at the beginning and end of the period showing:

(1) Additions

(2) Expense recognized on satisfaction of performance obligation

(3) Impairments

(4) Impairment losses reversed

(b) The circumstances or events that led to the reversal of a write-down of an asset arising from the costs of fulfilling a contract.

(c) The method used to determine the amortization amount for the period.

Structure of paper

4. This paper is organized as follows:

(a) Background information (paragraphs 5–7)

(b) Alternatives (paragraphs 8–17)

(c) Nonpublic entities (paragraphs 18–19)

(d) Appendix (paragraphs A1–A6)

Background information

5. The Exposure Draft, *Revenue from Contracts with Customers* (ED) did not include specific guidance on disclosures about the costs incurred to fulfill a contract. One respondent commented on the absence of disclosures in this area:

> The ED excludes disclosure requirements associated with costs recognized as expense or capitalized in accordance with the provisions of the proposed standard. We find this to be a substantial omission in the proposed standard. This exclusion is particularly unfortunate given that several U.S. entities have worked hard to provide comprehensive disclosures explaining their position with respect to cost deferral and subsequent recognition (amortization) in

> response to SAB 104 and the growth of the software as a services industry. We believe disclosures related to cost capitalization; allocation to performance obligations; amortization of costs; and a rollforward/reconciliation of capitalized costs should be included in any final standard. [CFA Institute]

6. The CFA Institute recommended a number of disclosures about costs that have been incorporated into the alternatives in this paper. However, the following disclosures recommended by the CFA Institute were not included as alternatives, but were considered by the staff:

    (a) Disclosing the basis for capitalizing costs

    (b) Impacts of foreign currency fluctuations and business combinations on capitalized costs

    (c) Expected run-off of capitalized costs

7. While those disclosure are similar to the disclosures about revenue included in the ED, the staff considered as alternatives only those disclosures recommended by the CFA Institute that are similar or the same as existing disclosures about costs in IFRSs and U.S. GAAP (see the Appendix for a summary of those disclosures). Some of those disclosures may be eliminated depending on where the cost guidance is located in IFRSs and in the Codification, while other disclosures are applicable only to certain industries (e.g. construction and production contracts). Therefore, the staff focused on developing disclosures that would improve consistency across industries and that could be included in one location. Additionally, the final standard would include consequential amendments that would eliminate overlapping disclosures.

Alternatives

8. Based on existing disclosures required under IFRSs for cost of inventories of a service provider, and under U.S. GAAP for precontract costs, pre-production costs, and other assets, as well as recommendations from users of financial statements, the staff considered several disclosures about assets arising from

acquisition and fulfillment costs, which are discussed in the following paragraphs.

Disclosures about assets arising from acquisition costs

9. At the March 2011 meeting, the Boards decided to change the ED's guidance that would have required an entity to recognize an expense for the costs of obtaining a contract with a customer. Instead, the Boards decided that an entity should recognize an asset for the incremental costs of obtaining a contract. Incremental costs are those costs that would not have been incurred if the contract had not been obtained (e.g., commissions and credit card fees).

10. Based on that decision, the staff recommends that the Boards require an entity to disclose the following information about an asset arising from the costs of acquiring a contract with a customer for each reporting period:

    (a) The nature and amount recognized as an asset arising from the cost incurred to acquire a contract with a customer as of the end of the reporting period.

    (b) The expense recognized on satisfaction of the performance obligation during the period and method used to determine that amount.

11. This disclosure would provide users of financial statements with information about the amount of costs that an entity incurs in acquiring its contracts that could be used by an investor to assess those costs in relation to other competitors or other industries, and whether those costs are significant in relation to other contract costs and revenues for the period. Additionally, it would provide information about the types of costs incurred (e.g. sales commissions).

12. While this disclosure would provide more information to users, in some industries the costs of obtaining a contract may not be significant to total contract costs and revenues. In those instances, the cost of requiring this disclosure may outweigh the benefits.

Staff recommendation

13. Because the incremental costs of obtaining a contract could be significant, the staff thinks an entity should disclose the nature and amount of the asset as of each reporting period, the expense recognized on satisfaction of the performance obligation during the period, and the amortization method. The staff spoke with several preparers and auditors who noted that in some industries, the amount recognized as an asset for the costs arising from obtaining a contract could be significant in relation to overall contract costs and profitability. Additionally, an entity would not be required to provide the disclosure if the amount is not material.

Question 1
The staff recommends that an entity disclose: 1) the nature and amount recognized as an asset arising from the cost incurred to acquire a contract with a customer as of the end of the reporting period 2) the amount recognized as an expense on satisfaction of the performance obligation during the period and method used to determine that amount Do the Boards agree?

Fulfillment cost reconciliation

14. Based on existing disclosures in IAS 2, *Inventories* that would be eliminated for cost of inventories of a service provider, and similar disclosures required by Subtopic 210-10-S99 for other assets, the staff considered the alternative of requiring entities to disclose a reconciliation of the carrying amount of an asset arising from the costs of fulfilling a contract, by major classification (e.g. precontract, setup, and other fulfillment costs) at the beginning and end of the period showing:

(i) Additions

(ii) Amortization

(iii) Impairments

(iv) Impairment losses reversed

15. For impairment losses reversed, an entity would disclose the circumstances or events that led to the reversal. Additionally, the staff considered requiring a description of the method used to amortize the asset.

16. This disclosure is similar to existing reconciliation disclosures in IAS 2, IAS 38, *Intangible Assets*, and Topic 350, Intangibles-Goodwill and Other. It would provide users with information about how an entity's assets arising from the cost of fulfilling a contract with a customer changed during the period, and the current cash outflows that an entity expends for a contract and expects to recover from future cash inflows from the customer. This information may be particularly useful when those assets and related amortization are not presented separately in the statement of financial position and statement of comprehensive income.

Staff recommendation

17. The staff recommends that the final standard require entities to disclose a reconciliation of assets arising from the costs of fulfilling a contract with a customer, as well as narrative descriptions of the method of amortization and reasons for reversals of impairments. The staff thinks that this is consistent with disclosures required in IFRSs and U.S. GAAP for other major types of assets, such as intangibles and inventory, and has been requested by users in their comment letters to the ED.

Question 2
The staff recommends requiring entities to disclose, for each reporting period, a reconciliation of the carrying amount of an asset arising from the costs to fulfill a contract with a customer, by major classification (e.g. precontract costs, setup costs, and other fulfillment costs), at the beginning and end of the period, separately showing: a) additions

b) amortization
c) impairments
d) impairment losses reversed

For impairment losses reversed, the circumstances that led to the reversal.

A description of the method used to determine the amortization for the period.

Do the Boards agree?

FASB Board only – nonpublic entities

18. The staff continues to conduct additional outreach with nonpublic entity constituents to evaluate whether nonpublic entities should be exempt from providing some of the revenue recognition disclosures in the proposed Update about assets arising from the costs that an entity incurs to acquire and fulfill a contract with a customer. The Board is not being asked to make any decisions about nonpublic entity disclosure exemptions at this time. The staff is considering this feedback and will provide the FASB Board with recommendations about potential disclosure exemptions for nonpublic entities at a subsequent FASB Board meeting.

19. The majority of nonpublic entity constituents do not think that the costs will outweigh the benefits of providing roll forward information. Preparers and auditors are concerned with the level of detail and costs associated with compiling this information. Some users have stated that they do not find all roll forward information decision-useful and they are concerned about disclosure overload. Nonpublic entities generally are not required to disclose reconciliations from the opening to the closing balance (roll forwards) of accounts included in the statement of financial position because their users often can obtain this information directly from management. The staff thinks that this exemption should apply to the roll forward disclosure requirement to include a

reconciliation of the carrying amount of the major classifications of assets arising from the costs of fulfilling a contract at the beginning and end of the period as noted in paragraph 14 of this memo.

Appendix

Existing disclosure requirements for acquisition and fulfillment costs

1. Under IFRSs, the staff notes that the guidance on fulfillment costs in the final standard would replace existing guidance in IAS 2, Inventories, on cost of inventories of a service provider. IAS 2 requires several disclosures that would no longer be applicable to cost of inventories of a service provider unless the guidance in the final standard is included in IAS 2, or new disclosures are developed that are similar to existing disclosures in IAS 2.

2. The applicable disclosures in IAS 2 include the following:

   (a) The total carrying amount of inventories and the carrying amount in classifications appropriate to the entity

   (b) The amount of inventories recognized as an expense during the period;

   (c) The amount of any write-down of inventories recognized as an expense in the period

   (d) Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are merchandise, production supplies, materials, work in progress and finished goods. The inventories of a service provider may be described as work in progress.

   (e) Some entities adopt a format for profit or loss that results in amounts being disclosed other than the costs of inventories recognized as an expense during the period. Under this format, an entity presents an analysis of expenses using a classification based on the nature of expenses. In this case, the entity discloses the costs recognized as an expense for raw materials and consumables, labor costs and other costs together with the amount of the net change in inventories for the period.

3. Under U.S. GAAP, several disclosures are required for other assets, preproduction costs, and precontract costs. Subtopic 210-10-S99, Balance Sheet, requires the following disclosures for other assets:

   (a) The amount of any other asset, either separately in the balance sheet or notes thereto, that is in excess of 5% of total assets

   (b) An explanation of any significant addition or deletion

   (c) The policy for deferral and amortization

4. For all long-term contracts or programs, Subtopic 210-10-S99, Balance Sheet, requires the following disclosures in the notes to the financial statements:

   (a) The aggregate amount of manufacturing or production costs and any related deferred costs (e.g. initial tooling costs) which exceeds the aggregate estimated cost of all in process and delivered units on the basis of the estimated average cost of all units expected to be produced under long-term contracts and programs not yet complete, as well as that portion of such amount which would not be absorbed in costs of sales based on existing firm orders at the latest balance sheet date. In addition, if practicable, the amount of deferred costs by type of cost (e.g., initial tooling, deferred production, etc.)

   (b) The aggregate amount representing claims or other similar items subject to uncertainty concerning their determination or ultimate realization, including a description of the nature and status of the principal items comprising such aggregate amount.

   (c) The amount of progress payments netted against inventory at the date of the balance sheet.

5. For pre-production costs related to long-term supply arrangements, Subtopic 340-10-S99, Other Assets and Deferred Costs, requires the following disclosures:

   (a) The accounting policy for pre-production design and development costs and the aggregate amount of:

(i) Assets recognized pursuant to agreements that provide for contractual reimbursement of pre-production design and development costs

(ii) Assets recognized for molds, dies, and other tools that the supplier owns

(iii) Assets recognized for molds, dies, and other tools that the supplier does not own

6. Additionally, Subtopic 910-340, Contractors-Construction, Other Assets and Deferred Costs, requires contractors to disclose the policy of deferral and the amount of costs deferred either in anticipation of future sales (precontract costs) or as a result of an unapproved change order.