

oil and gas producing activities and the full cost ceiling test?

**Interpretive Response:** Yes. The prohibition against the inclusion of gas derived from coal was meant to apply to the recovery of hydrocarbons from the processing of coal. The extraction of methane gas from coalbed seams using conventional methods was not contemplated at the time Rule 4–10(a) was developed. The staff believes that, since coalbed methane gas can be recovered from coal in its natural state and original location, it should be included in proved reserves, provided that it complies in all other respects with the definition of proved oil and gas reserves as specified in Rule 4–10(a)(2) including the requirement that methane production be economical at current prices, costs (net of the tax credit) and existing operating conditions.<sup>2</sup> Methane gas from coalbeds (like any other hydrocarbon obtained from conventional reservoirs) that cannot be produced at a profit under current economic and operating conditions, or for which there is no market or any existing method of delivery to the market, cannot be included in the category of proved reserves.

In instances where methane gas is deemed to be economically producible only as a consequence of existing Federal tax incentives, the staff believes that additional disclosure should be provided as to the specific quantities and values of reported proved reserves that are dependent on existing U.S. tax policy together with any other information necessary to inform readers of the risks attendant with any future change to existing Federal tax policy.

### Topic 13: Revenue Recognition

#### A. Selected Revenue Recognition Issues

##### 1. Revenue Recognition—General

The accounting literature on revenue recognition includes both broad conceptual discussions as well as certain industry-specific guidance. Examples of existing literature on revenue recognition include Statements 13, 45, 48, 49, 50, 51, and 66; Opinion 10; ARBs 43 (Chapter 1a) and 45; SOPs 81–1 and 97–2; EITF Issues 88–18, 91–9, 95–1, and 95–4; and Concepts Statement 5.<sup>1</sup> If a transaction is within

the scope of specific authoritative literature that provides revenue recognition guidance, that literature should be applied. However, in the absence of authoritative literature addressing a specific arrangement or a specific industry, the staff will consider the existing authoritative accounting standards as well as the broad revenue recognition criteria specified in the FASB's conceptual framework that contain basic guidelines for revenue recognition.

Based on these guidelines, revenue should not be recognized until it is realized or realizable and earned.<sup>2</sup> Concepts Statement 5, paragraph 83(b) states that “an entity's revenue-earning activities involve delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations, and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues” [footnote reference omitted]. Paragraph 84(a) continues “the two conditions (being realized or realizable and being earned) are usually met by the time product or merchandise is delivered or services are rendered to customers, and revenues from manufacturing and selling activities and gains and losses from sales of other assets are commonly recognized at time of sale (usually meaning delivery)” [footnote reference omitted]. In addition, paragraph 84(d) states that “If services are rendered or rights to use assets extend continuously over time (for example, interest or rent), reliable measures based on contractual prices established in advance are commonly available, and revenues may be recognized as earned as time passes.”

The staff believes that revenue generally is realized or realizable and earned when all of the following criteria are met:

- Persuasive evidence of an arrangement exists,<sup>3</sup>

auditing procedures for revenue recognition and identifies indicators of improper revenue recognition.

<sup>2</sup> Concepts Statement 5, paragraphs 83–84; ARB 43, Chapter 1A, paragraph 1; Opinion 10, paragraph 12. The citations provided herein are not intended to present the complete population of citations where a particular criterion is relevant. Rather, the citations are intended to provide the reader with additional reference material.

<sup>3</sup> Concepts Statement 3, Qualitative Characteristics of Accounting Information, paragraph 63 states “Representational faithfulness is correspondence or agreement between a measure or description and the phenomenon it purports to represent.” The staff believes that evidence of an exchange arrangement must exist to determine if the accounting treatment represents faithfully the transaction. See also SOP 97–2, paragraph 8. The

• Delivery has occurred or services have been rendered,<sup>4</sup>

- The seller's price to the buyer is fixed or determinable,<sup>5</sup> and
- Collectibility is reasonably assured.<sup>6</sup>

##### 2. Persuasive Evidence of an Arrangement

###### Question 1

**Facts:** Company A has product available to ship to customers prior to the end of its current fiscal quarter. Customer Beta places an order for the product, and Company A delivers the product prior to the end of its current fiscal quarter. Company A's normal and customary business practice for this class of customer is to enter into a written sales agreement that requires the signatures of the authorized representatives of the Company and its customer to be binding. Company A prepares a written sales agreement, and its authorized representative signs the agreement before the end of the quarter. However, Customer Beta does not sign the agreement because Customer Beta is awaiting the requisite approval by its legal department. Customer Beta's purchasing department has orally agreed to the sale and stated that it is highly likely that the contract will be approved the first week of Company A's next fiscal quarter.

**Question:** May Company A recognize the revenue in the current fiscal quarter for the sale of the product to Customer Beta when (1) the product is delivered by the end of its current fiscal quarter and (2) the final written sales agreement is executed by Customer Beta's authorized representative within a few

use of the term “arrangement” in this SAB is meant to identify the final understanding between the parties as to the specific nature and terms of the agreed-upon transaction.

<sup>4</sup> Concepts Statement 5, paragraph 84(a), (b), and (d). Revenue should not be recognized until the seller has substantially accomplished what it must do pursuant to the terms of the arrangement, which usually occurs upon delivery or performance of the services.

<sup>5</sup> Concepts Statement 5, paragraph 83(a); Statement 48, paragraph 6(a); SOP 97–2, paragraph 8. SOP 97–2 defines a “fixed fee” as a “fee required to be paid at a set amount that is not subject to refund or adjustment. A fixed fee includes amounts designated as minimum royalties.” Paragraphs 26–33 of SOP 97–2 discuss how to apply the fixed or determinable fee criterion in software transactions. The staff believes that the guidance in paragraphs 26 and 30–33 is appropriate for other sales transactions where authoritative guidance does not otherwise exist. The staff notes that paragraphs 27 through 29 specifically consider software transactions, however, the staff believes that guidance should be considered in other sales transactions in which the risk of technological obsolescence is high.

<sup>6</sup> ARB 43, Chapter 1A, paragraph 1 and Opinion 10, paragraph 12. See also Concepts Statement 5, paragraph 84(g) and SOP 97–2, paragraph 8.

<sup>2</sup> Proved oil and gas reserves are the estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. (Emphasis added.)

<sup>1</sup> In February 1999, the AICPA published a booklet entitled “Audit Issues in Revenue Recognition.” This booklet provides an overview of the current authoritative accounting literature and