



Revenue from Contracts with Customers

Zurich Conference July 2011

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

Agenda

- Background to the project
- Summary of the proposed standard
- Feedback on the exposure draft
- Re-deliberations of the exposure draft
- What happens next?

Why we're doing the project

- IFRSs and US GAAP are different. Both need improvement:
 - US broad recognition concepts; numerous requirements by industry
 - IFRSs have two alternative standards; can be difficult to apply
- Objective - a single, principles-based revenue recognition standard for use across various industries and capital markets
 - replace IASs 18 & 11 and most of Topic 605 in FASB Accounting Standards Codification

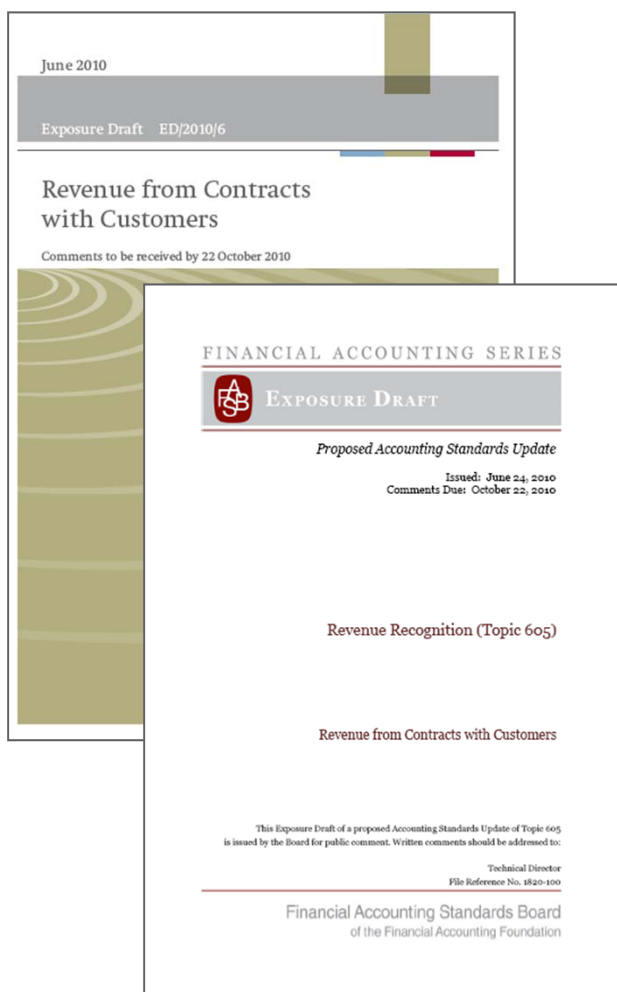
Improvements to financial reporting

- Single model based on clear principles
- Will improve accounting for contracts with customers by:
 - providing a more robust framework for addressing issues as they arise
 - increasing comparability across industries and capital markets
 - providing enhanced disclosures
 - clarifying accounting for contract costs

Scope

	Excluded	Included
CONTRACTS WITH CUSTOMERS	Lease contracts	All other contracts with customers including unbundled services from lease and insurance contracts
	Insurance contracts	
	Financial instruments including financial services fees that are an integral part of the effective interest rate	

The exposure draft



- Converged proposal with unanimous support of both the IASB and the FASB
- Published for public comment on 24 June 2010. Comment period ended 22 October 2010.
- Standard will replace IAS 18 *Revenue* and IAS 11 *Construction Contracts* and related interpretations

Feedback on the exposure draft

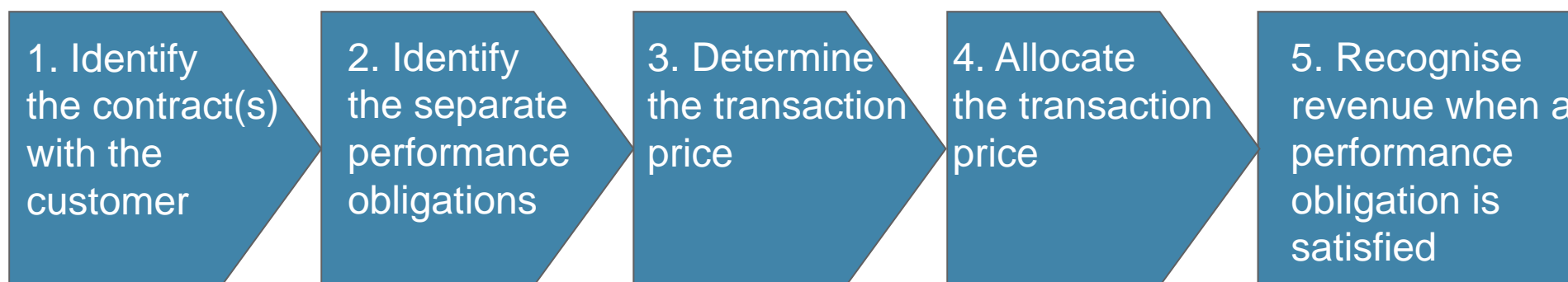
- Comment letter period ended 22 October 2010
- Good level of responses
- Support for project objective and core principle
- Clarify operation of the principles. Guidance needed on the practical application of
 - the concept of control as it relates to services
 - the principle of distinct goods and services for identifying separate performance obligations

Summary of the standard

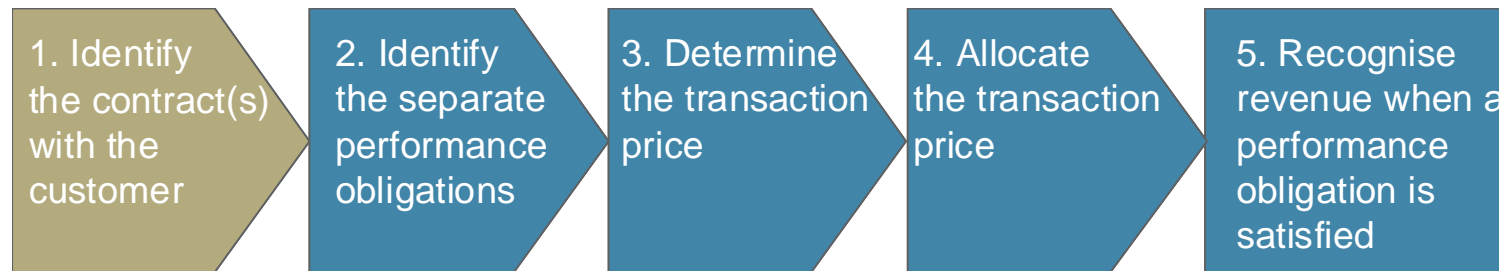
Core principle:

Recognise revenue to depict the *transfer* of goods or services in an amount that reflects the consideration expected to be received in exchange for those goods or services

Steps to apply the core principle:



Step 1 Identify the contract with the customer

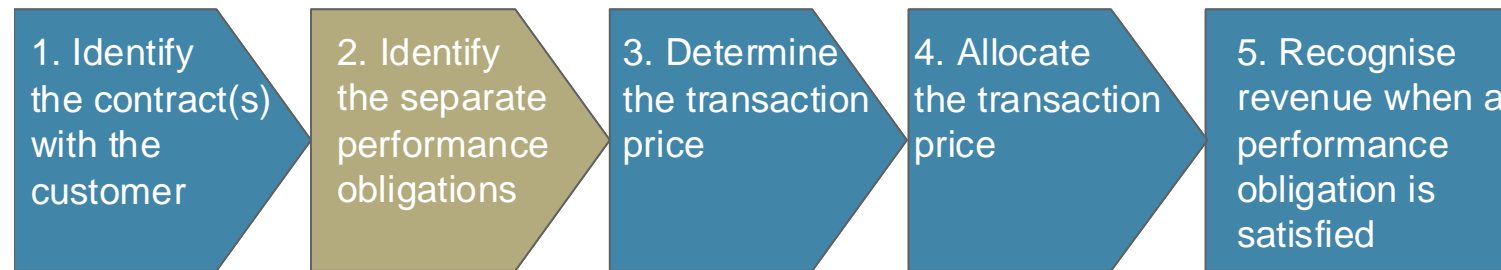


Key proposal: price interdependence - extended

- Combine contracts entered into at or near the same time, with the same customer, if
 - negotiated with a single commercial objective
 - the amount of consideration is interdependent
 - goods and services are inter-related in terms of design, technology or function

Step 2 Identify separate performance obligations

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Key proposal: distinct goods or services

- separate performance obligation is a promise to transfer a *distinct* good or service to the customer
- a good or service is distinct if it:
 - is sold separately, or
 - can be used on its own or with readily available resources

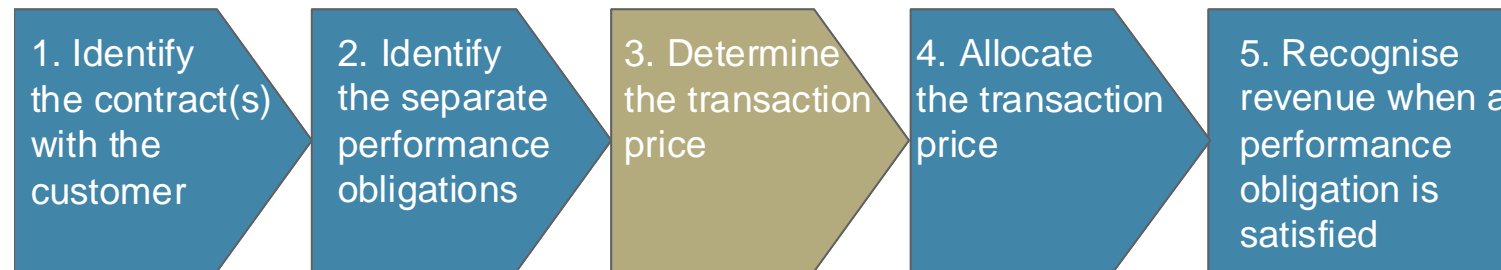
Re-deliberated performance obligations

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- One performance obligation if a bundle of highly inter-related goods and services and the contract includes significant integration of those goods & services into the item for which customer has contracted
- Otherwise separate performance obligations if:
 - the good or service is distinct and
 - pattern of transfer of the good or service is different from that of other goods or services in the contract

Step 3 Determine the transaction price

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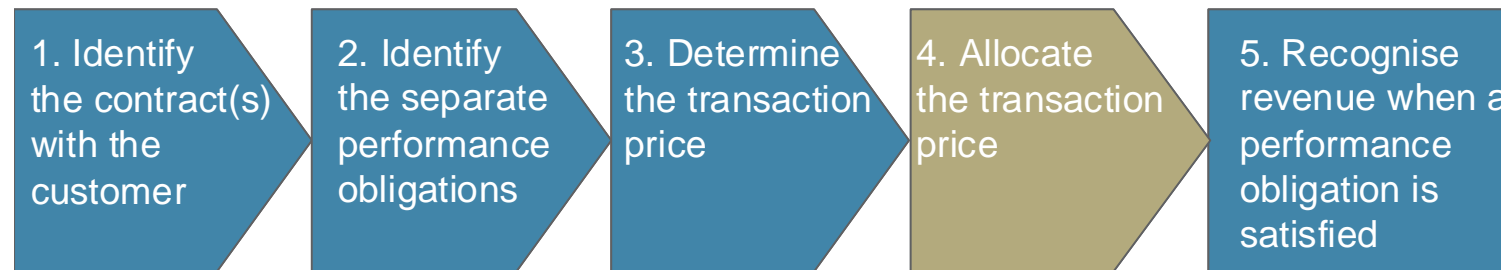


Key proposal: expected amount

- transaction price is the expected consideration from the customer and reflects implicit financing
- uncertain consideration estimated at probability-weighted or most likely amount
- recognise revenue if reasonably assured to be entitled to that amount

Step 4 Allocate the transaction price

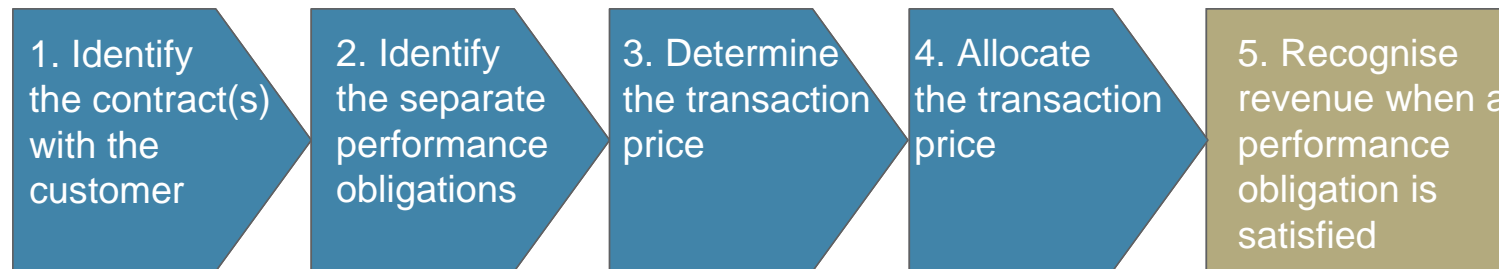
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Key proposal: relative selling price allocation

- transaction price allocated to the separate performance obligations on relative selling price basis
- selling prices estimated if necessary
- residual may be used to estimate standalone selling price if the selling price of a good or service is highly variable

Step 5 Recognise revenue



Key proposal: transfer based on control

- recognise revenue when a performance obligation is satisfied by transferring a good or service to customer
- transferred when customer obtains control
 - ability to direct the use of and receive the benefit from
- control works well for resources transferred at a point in time

Clarified continuous transfer

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Key proposal still transfer to customer

- Transfer is continuous if:
 - entity's performance creates or enhances an asset customer controls or
 - entity's performance does not create an asset with alternative use to the entity and one of:
 - customer receives benefit as entity performs, or
 - task would not need to be re-performed (without the benefit of any inventory transfer), or
 - entity has right to payment for performance

The re-deliberation process

- Comment letter analysis provides the basis
- Re-deliberations **clarify** the boards' intentions
 - when does transfer to the customer occur
 - how are separate performance obligations identified
- Re-deliberations **simplify** the proposals
 - especially for measurement
- Re-deliberations **align** the proposals with current practice
 - warranties, licenses, onerous, acquisition costs

Outreach adds depth to re-deliberations

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- Revenue affects all entities
- Revenue affects everyone in an organisation – not just finance
- More than 200 meetings or events on six continents to get the ED's message across
- Targeted outreach with affected sectors (eg construction, software, telecoms, pharma)
- Exploit technology – video conferencing, podcasts, webinars, email alerts

How outreach helps – eg construction

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- Practical application of core principles of identifying performance obligations and recognition of transfer clarified using construction contracts
- Frequent, in-depth outreach to understand the transactions, refine the boards' thinking and then test the wording
- Testing the drafting against the issues raised by IFRIC 15 *Agreements for the Construction of Real Estate* to ensure clear principles, consistently applied

Re-deliberations - measurement

Proposal in exposure draft	Re-deliberations
Estimate uncertain consideration at probability weighted amount	Use most predictive estimation technique – either probability weighted or most likely
Recognise revenue only if the transaction price can be reasonably estimated	Recognise revenue if reasonably assured to be entitled to that amount
The transaction price includes the effects of the time value of money	Adjust the promised amount of consideration to reflect the time value of money if a significant financing component
The promised consideration should reflect the effects of the customer's credit risk	These adjustments should be presented as a separate line adjacent to revenue

Other re-deliberations

Proposal in exposure draft	Re-deliberations
The onerous test should be performed at the level of each performance obligation	Onerous test limited to those satisfied over time. Costs applied are lower of direct costs and the amount paid to cancel the contract
Contract acquisition costs should be recognised as an expense as incurred	Acquisition costs should be recognised as an asset for the incremental costs that the entity expects to recover
Distinguishes two warranties, both defer revenue based on a selling price	A warranty should be recognised as a cost accrual if the customer does not have the option to purchase separately and it only provides assurance performance as specified
Account for licences based on exclusivity	Licences transfer at a point in time

Contract costs developed

- Costs may give rise to an asset recognised in accordance with other standards eg inventory
- Recognise contract fulfilment costs as asset if:
 - generate or enhance a resource used to satisfy performance obligations in the contract
 - relate directly to a contract (or anticipated contract) and
 - expected to recover under the contract

Enhanced disclosures to help users understand the amount, timing and uncertainty of revenue and cash flows

- Information about contracts with customers
 - disaggregation of revenue
 - maturity analysis of specific remaining performance obligations
 - reconciliation from opening to closing total contract balances
- Information about judgments and changes in judgments
 - timing of revenue recognition
 - determining and allocating the transaction price

- Retrospective application, but reliefs granted:
 - for contracts that begin and end in the same comparative reporting period
 - to allow the use of hindsight in estimating uncertain consideration
 - not to require the onerous test in comparative periods
 - not to require disclosure of the maturity analysis of performance obligations for comparative periods

Summary of effect of proposals

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- No change for many transactions
- Principle-based standard to give robust application
 - reduces the need for interpretations
 - prevents gaps being filled by local or imported rules
 - ‘future proofs’ guidance by creating a clear framework as transactions change
- A single, global revenue recognition framework
 - across all industries
 - across all markets

Effect on current practice

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- Revenue attributed to all performance obligations not just main deliverable
 - depicts transfer to customer
- Use of estimates when separating obligations better reflects transfer of different deliverables
 - removes constraints imported from US GAAP on software
 - revenue will be allocated to deliverables not sold alone based on an estimated selling prices
 - rules-based deferred revenue will disappear

Revenue allocated to all deliverables

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A telecoms company sells a mobile phone and unlimited calls and texts to Customer A. The phone is free if the customer signs up for a year - the network service is CU40 pm. The company also sells the same phone to Customer B for CU300, with the same service provided for CU15 pm.

At present, many companies would

recognise no revenue on delivery of one phone and CU300 as revenue on delivery of the other. The same service would be recognised at CU40 for Customer A and CU15 each month for Customer B.

Under the proposals

revenue would be recognised at similar amounts for each phone and service based on selling price

Consistent depiction of transfer

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A games company sells boxed video games that can be played on a console or online. The games company provides two deliverables to its customer – the video game and the online games service

At present, cannot recognise revenue on delivery of game

because there is no evidence of its standalone selling price

Under the proposals

the standalone selling price of each will be estimated and revenue recognised on each when transferred to the customer

Consistent recognition framework

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Fund managers' fees are based on the increase in value of the funds they manage. If the value has increased at the end of Q1, should they recognise fees on that basis?

At present, some recognise all the increase, some none and some pro-rata the increase

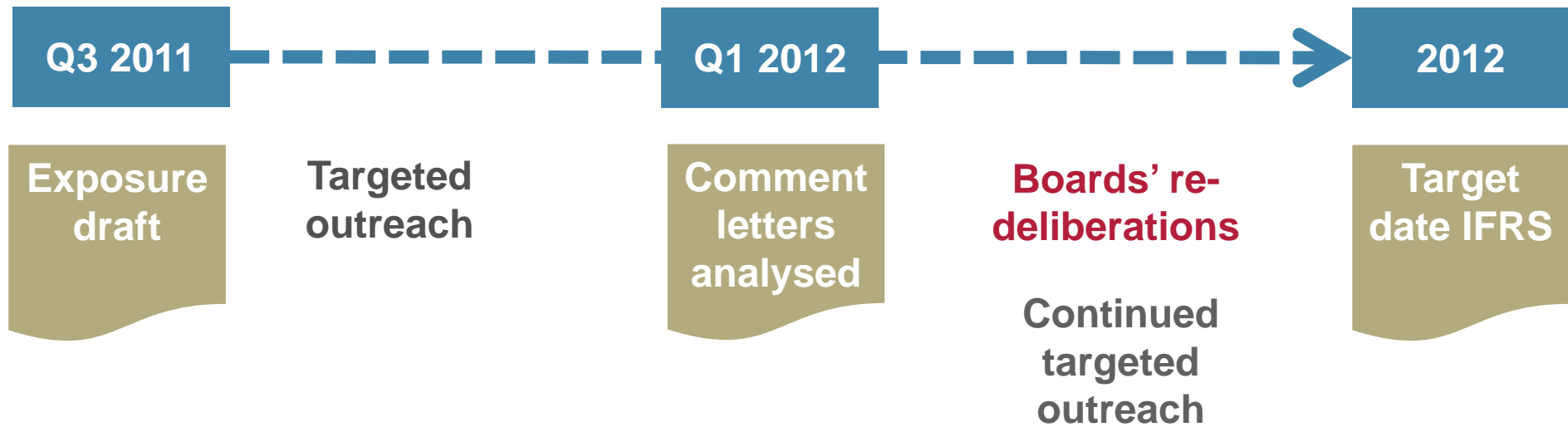
Under the proposals

revenue will be recognised if it reasonably assured that ultimately the entity will be entitled to those fees.

What happens next?

- Although not technically required, the boards will re-expose their proposals in Q3 2011
 - because of the prominent role of revenue in financial statement analysis
 - ‘important that we get this right, first time’
- Focus is on drafting as well as re-exposure of a selected number of changes to the proposals in the 2010 ED
- Will be out for comment for 120 days
- Effective date?

Timeline for completion



Where to get more information

- Visit the project web site and subscribe for email alerts:

<http://go.iasb.org/revenue+recognition>

- Project staff

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Questions or comments?

Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.

