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International Accounting Standards Board

This document is provided as a convenience to observers at the Analyst Representative Group meeting, to assist them in following the discussions. It does not represent an official position of the IASB. Board positions are set out in Standards.

Note: These notes are based on the staff papers prepared for the ARG meeting. Paragraph numbers correspond to paragraph numbers used in the ARG agenda paper.

INFORMATION FOR OBSERVERS

ARG Meeting: **November 2007, London**

Project: **Revenue Recognition**

(Agenda Paper 3A)

INTRODUCTION

1. The purpose of this meeting is to update you about progress in this project and to discuss two revenue recognition models that have been developed. We want to get your reaction to these models and to get input on user issues concerning revenue recognition.

PROJECT BACKGROUND

2. In 2002, the Board commenced its project on revenue recognition jointly with the FASB. The objective of the project is to develop a comprehensive standard on revenue recognition that would be based on an asset and liability model. In such a model, revenue is a function of changes in assets and liabilities and is not based on the notions of realisation and the completion of an earnings process.

3. Progress was limited in developing a model due to fundamental differences in Board members' views on several key issues. Board members seemed to fall within one of two camps. Some Board members preferred a model in which the assets and liabilities would be measured at fair value (a so-called fair value model). Others preferred a model in which the assets and liabilities would be measured by reference to the customer consideration (a so-called allocated customer consideration model). Each of these models had some support on both of the Boards: there was not a clear majority among Board members for either of the two models.

4. Accordingly, in October 2006 the Boards decided to develop both of these models independently. Instead of trying to forge a single, compromise model at this stage in the project, they decided that they should aim to get a better and more complete understanding about what both models would look like and what each would entail. They also decided that an initial due process document could explain and illustrate the two models and that this would provide an appropriate basis for seeking constituent feedback.

5. Therefore, over the last year, the staff and two small groups of Board advisers (each drawn from both boards) have developed two revenue recognition models. At the IASB's meeting with the FASB in October, the staff provided a summary of each of the models—the Measurement model (formerly the fair value model) and the Customer Consideration model. These models are attached as Appendices A and B.

6. The summaries of the models prepared for the October joint meeting will form the basis of the due process document. Hence, the Board envisage that the due process document will be a discussion paper containing an explanation of both models and a set of illustrative examples. The Boards view the due process document as the opportunity to seek input on two different revenue recognition models.

7. Because the document will illustrate both models, constituents should be able to express their views about which model they think represents the greater improvement to current practice. The Boards can then use this input in the next stage of the project as they go on to develop a single, general comprehensive standard on revenue recognition.

INTRODUCTION TO THE TWO MODELS

Shared characteristics of the two models

8. In both models, revenue arises from recognising increases in specified assets and decreases in specified liabilities, rather than from a separate evaluation of how much performance occurred in a period. In other words, the amount of revenue to be recognised is determined by considering how much assets and liabilities change in a period.

9. The specified assets and liabilities in both models are those that arise directly from enforceable contracts with customers. A contract can be either an asset or a liability to the entity, depending on the remaining unperformed rights and obligations in the contract. A contract would be an asset (a contract asset) to the entity if the remaining unperformed rights exceed the remaining unperformed obligations. A contract would be a liability (a contract liability) to the entity if the remaining unperformed obligations exceed the remaining unperformed rights.

Measurement model overview

10. To measure the asset or liability arising from the contract, the underlying unperformed rights and obligations in the contract are measured at their current exit price. This is the price that a market participant would pay (or require) to obtain (or assume) the remaining unperformed rights and obligations in the contract. The contract is measured this way at inception and subsequently.

11. Because the model focuses on the contract asset and liability, revenue is defined as an *increase* in a contract asset or a *decrease* in a contract liability. Hence, revenue is *recognised* when:

- an entity obtains a contract in which the underlying rights exceed the underlying obligations (because this would result in a new contract asset).
- the entity subsequently satisfies its obligations in the contract by providing goods or services to the customer (because this would either increase a contract asset or decrease a contract liability).

12. The *amount* of revenue that is recognised is derived from the *increase* in the exit price of the contract asset or *decrease* in the exit price of the contract liability.

13. Because the model is predicated on explicit measurements of the assets and liabilities, it is described as the *measurement model*.

Customer consideration model overview

14. To measure the contract under this model, the underlying rights in the contract are measured at inception at the amount promised by the customer (often referred to as the customer consideration). That amount is then also allocated to the separate performance obligations identified within the contract based on the sales price of the good or service underlying each performance obligation. The amount of the identified performance obligations in total always equals the customer consideration at inception.

15. Because the customer consideration amount is allocated to the identified performance obligations, the sum of these performance obligations and the measure of the rights are equal at inception. Thus, the measure of the contract at inception is typically zero—neither an asset nor a liability arises at contract inception.

16. Separate performance obligations within the contractual obligations are identified at inception, based on the timing and nature of their extinguishment. As each performance obligation identified in the contract is satisfied, the resulting decrease in the contract liability or increase in the contract asset results in the recognition of revenue.

17. In this model, revenue is the decrease in contract liability, or increase in contract asset, that results from an entity satisfying its performance obligations.

SUMMARY COMPARISON OF THE TWO MODELS

18. The two models are compared in the summary table below:

	Measurement Model	**Customer Consideration Model**
What is revenue?	An *increase* in a contract asset or a *decrease* in a contract liability that results from (a) obtaining an enforceable contract with a customer to provide goods and services and (b) providing those goods and services to the customer.	An *increase* in a contract asset or a *decrease* in a contract liability that results from an entity satisfying its performance obligations.
	Contract Inception	
Measurement of contract at inception	Measure the remaining rights and obligations in the contract at their current exit price.	Measure the rights in the contract at the amount of consideration received or receivable. The amount of consideration received or receivable is then allocated to the identified performance obligations based on the separate selling price of the underlying good or service.
Identifying the separate performance obligations	At any reporting date, the entity measures *all* of the remaining unperformed obligations in the contract. All obligations to a customer arising from the contract are included in the measurement of the contract (including obligations such as warranties and return rights).	The identified performance obligations are restricted to the obligations agreed upon by the entity and its customer in the contract. 'Ancillary obligations' may arise at contract inception but outside the terms of the contract itself. These are not considered performance obligations. No consideration is allocated to these obligations.
Can some <u>revenue</u> arise at contract inception?	Yes (if current exit price of rights obtained > current	No

	Measurement Model	**Customer Consideration Model**
	exit price of obligations incurred).	
Can some profit arise at contract inception?	Yes (if current exit price of rights obtained less current exit price of obligations incurred > contract acquisition expenses).	No
Can some loss arise at contract inception?	Yes (if the contract acquisition expenses > current exit price of rights obtained less current exit price of obligations incurred; or if current exit price of obligations incurred > current exit price of rights obtained).	Yes (for all the contract acquisition expenses. An additional loss will also arise if the contract is judged to be onerous.)
After Contract Inception		
Measurement of contract after inception	Measure remaining rights and obligations in the contract at their current exit price.	Measure remaining rights at the amount of remaining consideration receivable. Measure remaining obligations at the amount of consideration that was allocated to those obligations at contract inception unless those obligations are judged to be onerous. If onerous, recognise an additional liability.
If there is a change in price for goods and services still to be provided, does the carrying amount of the performance obligations change?	Yes (if there is a change in the current exit price of the goods and services to be provided).	No (unless the contract is determined to be onerous).
When is revenue recognised?	As obligations are satisfied (i.e. as goods and services transfer to customer).	As performance obligations are satisfied (i.e. as goods and services transfer to customer).

	Measurement Model	**Customer Consideration Model**
How is the amount of revenue determined	By reference to the current exit price of the obligations that have been satisfied—i.e. current price of goods and services provided in period.	By reference to the contract consideration that was initially allocated to the obligations that have been satisfied—i.e. amount of contract consideration attributed to goods and services provided in the period.

ISSUES FOR CONSIDERATION BY THE ARG

19. We would welcome your comments and observations on the models. Specifically:

- Do these models in any way improve things for you? How?
- Do these models in any way make things worse for you? How?
- Are there key issues or problems you experience today that the models do not address? What are these issues?