Financial Accounting Standards Board

International Accounting Standards Board

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INFORMATION FOR OBSERVERS

IASB/FASB Meeting: **21 April 2008,London**

Project: **Revenue Recognition**

Subject: **PAAinE Discussion Paper: *Revenue Recognition — A European Contribution***

At the Boards' joint meeting, EFRAG and DRSC representatives will present an overview of the discussion paper *Revenue Recognition — A European Contribution* (DP). The DP was issued in July 2007 and was prepared jointly by the staff of the German standard setter (DRSC) and by the staff of the European Financial Reporting Advisory Group (EFRAG) as part of Europe's PAAinE (Pro-active Accounting Activities in Europe) initiative. The paper's objective is to stimulate debate on revenue recognition in Europe and to develop European views to be considered by the IASB and FASB in their joint revenue recognition project.

The full DP can be downloaded from http://www.efrag.org/projects/detail.asp?id=55

The DP's summary is reproduced below.

APPENDIX A
SUMMARY OF "REVENUE RECOGNITION: A EUROPEAN CONTRIBUTION"

(The following is an extract from the discussion paper)

a Revenue issues have increasingly been the source of discussions amongst those applying, interpreting or enforcing accounting standards. This is partly due to the fact that new business models have evolved and new transaction types have emerged (such as multiple element arrangements) for which current IFRSs do not offer sufficient guidance. It is also because there are conceptual inconsistencies between IAS 18 *Revenue,* IAS 11 *Construction Contracts* and the IASB's *Framework for the Preparation and Presentation of Financial Statements*. The result is that different practices have been adopted and inconsistencies and uncertainties have arisen.

b Yet revenue—by which we mean the top-line of the income statement—is a very important number for users; one for which we need clear, consistent and comprehensive principle-based standards.

c Against this background the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) decided in 2002 to start a joint project on revenue recognition and measurement. The objective of the project is to develop a comprehensive set of conceptually-based principles that will eliminate existing inconsistencies, fill voids that have emerged and provide guidance that will be useful in addressing issues that may arise in the future.

d Recognising the need for Europe to get involved now if it is to participate effectively in the revenue debate, the DRSC and EFRAG decided to work together to prepare a paper that would stimulate debate within Europe and to encourage the development of European views on the subject. This paper is the result of that work. It examines revenue recognition from first principles, with the aim of establishing a framework within which to address in a consistent way the revenue issues that are arising and will arise in the future.

e The existing conceptual frameworks of the IASB and FASB provide the basis both for the work being undertaken by the IASB and FASB in their joint project and for this paper. At the core of those frameworks—and therefore of this paper—is the so-called assets/liabilities approach.

f The paper develops, through deduction and analysis, a working definition of revenue: revenue is the gross inflow of economic benefits that arises as an entity carries out activities pursuant to a contract with a customer (see Chapter 2).

g Concluding that revenue should be recognised as soon as it arises and is measurable, the discussion in Chapters 3 and 4 then focuses on the question: when does revenue arise?

The paper approaches this issue by considering some simple transactions and exploring, modifying and further exploring various views of revenue. Through this process, four possible views of revenue and approaches to revenue recognition are highlighted—Approaches A to D—and the paper analyses those approaches in detail.

h It emerges through this work that there are two very different types of revenue recognition approach—the critical events approach and the continuous approach— and they are based on very different views of how revenue arises.

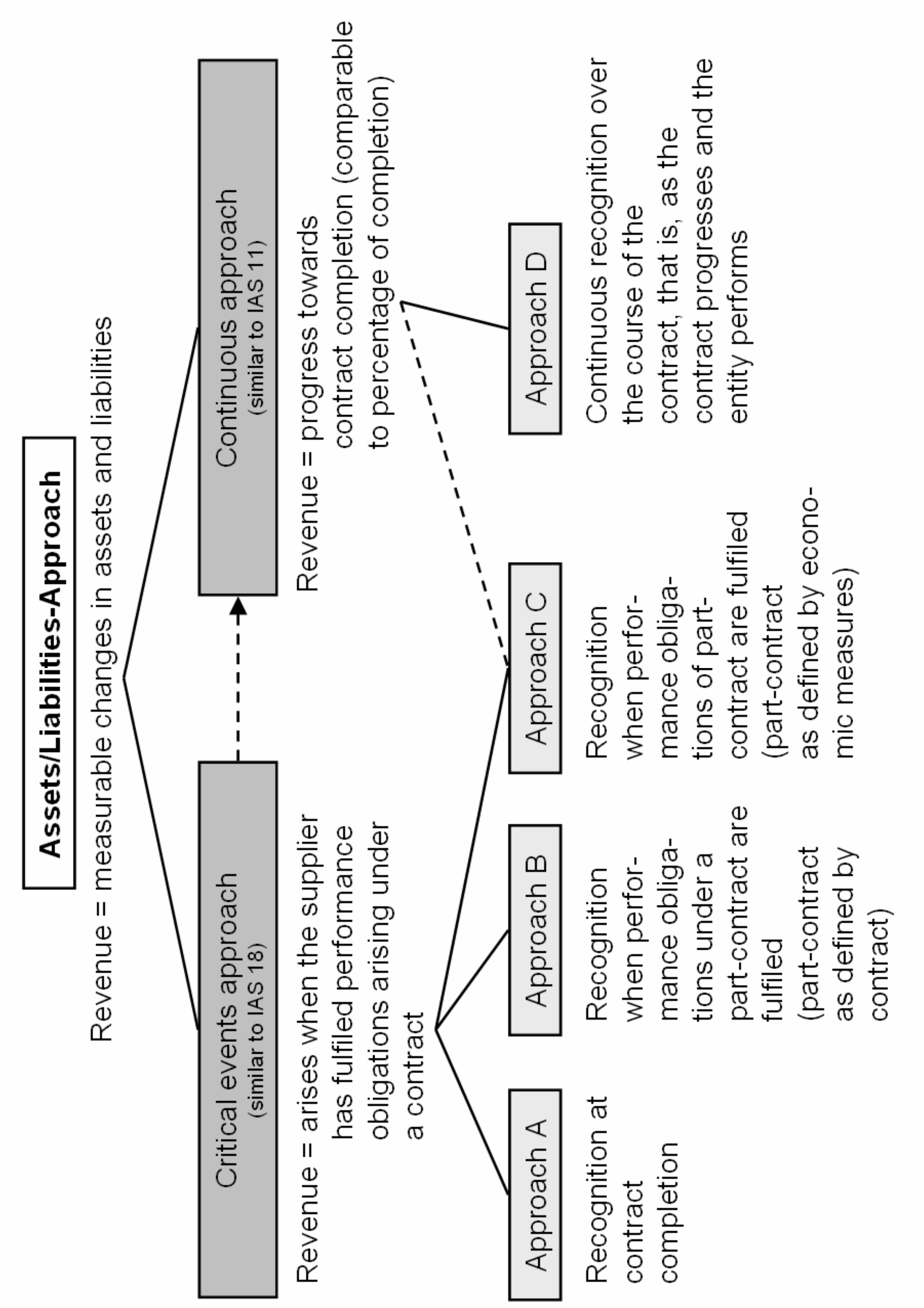
i Under a critical events approach, revenue reflects fulfilment of all or just some of performance obligations entered into through a contract with a customer. Under such an approach, no revenue arises under a contract until a particular event or threshold in the contract (the critical event) has been reached; then all the revenue arises either on the critical event occurring or between that point and the end of the contract. IAS 18 is based largely on a critical event approach. Different critical events result in different critical event approaches. The critical event approach is explored in Chapter 3, and three particular approaches (Approaches A, B and C) are discussed in detail. All those approaches are based on the basic premise that revenue is what an entity gets when it has done something it promised to do for a customer—although they are based on different views as to what that 'something' should be.

j The continuous approach (Approach D) takes a different route; revenue is something that arises as the supplier does something, not once it has done it. Under this approach revenue arises continuously over the course of the contract as the contract progresses and the supplier performs. As a result, rather than having to focus on critical events, the approach adopts the simpler approach of asking how far the contract has progressed. Various measures can be used to determine progress. The underlying principle is very similar to the percentage-of-completion method described in existing IAS 11.

k The chart on the next page summarises the approaches covered by this paper. It shows the basic nature and major characteristics of the two types of approach and the four specific approaches explored in detail.

l The paper's discussion of the differences between and merits of the various approaches described will, the authors believe, provoke plenty of debate within Europe and elsewhere on this important issue—and provoking debate and encouraging Europe to develop views is what this paper is primarily about. However, for the record, the DRSC, having discussed the issues in detail and at length, has concluded that the continuous approach offers a solution for the accounting for multiple element arrangements as well as for the problem of conceptual inconsistencies among current standards and the Framework. For that reason it would propose in effect applying the 'percentage-of-completion method' generally, rather than limiting its application to long-term construction contracts. EFRAG and the CNC, on the other hand, have decided not to state a preference in this paper, although they do agree that a single approach needs to be applied to all transactions.

- The authors would welcome comments on the discussion in this paper. An Invitation to Comment is set out in the next section of the paper.


Assets/Liabilities-Approach
Revenue = measurable changes in assets and liabilities
Critical events approach
(similar to IAS 18)
Continuous approach
(similar to IAS 11)
Revenue = arises when the supplier has fulfiled performance obligations arising under a contract
Revenue = progress towards contract completion (comparable to percentage of completion)
Approach A
Approach B
Approach C
Approach D
Recognition at contract completion
Recognition when perfor-mance obliga-tions under a part-contract are fulfiled (part-contract as defined by contract)
Recognition when perfor-mance obliga-tions of part-contract are fulfiled (part-contract as defined by econo-mic measures)
Continuous recognition over the course of the contract, that is, as the contract progresses and the entity performs