



**International
Accounting Standards
Board**

30 Cannon Street, London EC4M 6XH, England
Phone: +44 (0)20 7246 6410, Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: <http://www.iasb.org>

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

INFORMATION FOR OBSERVERS

Global Preparers Forum Meeting: July 2008, London

Project: Revenue recognition

(Agenda Paper 8)



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Global Preparers' Forum

Revenue recognition project

Joint Project with the FASB

*The views expressed in this presentation are those of the presenter,
not necessarily those of the IASB*



Project background

- Long standing, joint project
- Revenue recognition based on changes in assets and liabilities
- Develop a single, principles-based standard to deal with all types of contracts and business sectors
- Converge US and IFRS requirements
 - Detailed US guidance often targets specific sectors – 200+ statements
 - IFRS splits transactions between Revenue and Construction contracts



Since last time...

- **October 2006 - two models proposed for separate development**
 - **Customer consideration**
 - **Fair value**
- **October 2007 – converged the recognition model; two possible measurement approaches**
- **May 2008 – adopted the customer consideration measurement approach**



Why was fair value rejected?

- **Observable and verifiable**
 - Customer consideration is observable and verifiable at total contract value level
 - Practical difficulties with fair value, especially where no identifiable market for trading transactions
- **Revenue at inception**
 - Risk it may arise from measurement errors
 - Many reject revenue before satisfaction of obligations
- **Relevance and understandability**
 - Transaction price is easily understood
 - Is FV useful where the transaction could not be laid off?



Contract based model

- Based on accounting for a contract with a customer
- Promises made convey rights and impose obligations
- The rights under the contract are to the customer's performance, ie payment
- The obligations under the contract are the promises an entity makes to provide goods and services to the customer

How do rights and obligations change?



- As the contract progresses the remaining rights and obligations of the contract will change.
- The rights will reduce as the customer performs under the contract and pays.
- The obligations will reduce as the entity provides what was promised to its customer - goods or services.
- The rights → cash; obligations → revenue

Measurement of rights and obligations



- The rights are measured at the amount of customer consideration
- The performance obligations are also measured at the customer consideration amount.
- At inception, no contract asset or liability is recognised. No revenue is recognised at inception.

Allocation of customer consideration to obligations



- The amount of the total customer consideration is allocated over the identified performance obligations, pro-rata the estimated selling price of each as a proportion of the whole.
- Separate performance obligations are identified at inception.
- A performance obligation is something which is sold separately, or could be sold separately.
- As the performance obligation is satisfied the contract asset increases (or contract liability decreases) and revenue is recognised.

When are performance obligations satisfied?



Recognition of revenue is based on the transfer of goods and services to a customer:

Good

- when enforceable rights to good transfer to customer
- eg contract for sale of widget – typically on delivery

Service

- when service or access to service is provided
- eg contract to provide a warranty – as service of warranty coverage provided



Advantages of the model

- **Accounting for change in contract asset or liability clarifies recognition**
 - Satisfaction of a performance obligation clarifies when revenue is earned
- **Revenue is attributed to all performance obligations**
 - Warranties are revenue earning services not cost accruals
- **Estimation of components in US will provide more faithful depiction of transaction**
- **Integration of model with order book and cash flow will provide more useful disclosure.**



Unanswered questions

- Is the satisfaction of an obligation a model which can be used for all types of contracts?
 - Will affect some construction contracts if WIP does not transfer continuously
 - Under what conditions does WIP transfer, giving continuous satisfaction of obligations?
 - Up-front fees
- Generally performance obligations are not re-measured, unless onerous.
 - Other circumstances?
- Disclosure is being addressed early