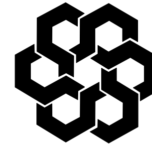

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International Accounting Standards Board

This document is provided as a convenience to observers at the Global Preparers Forum 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 GPF meeting. Paragraph numbers correspond to paragraph numbers used in the GPF agenda paper.

INFORMATION FOR OBSERVERS

GPF Meeting:	**November 2008, London**
Project:	**Revenue recognition**

(Agenda Paper 3)

Revenue recognition

IASB's joint project with the FASB

Global Preparers' Forum 11 November 2008

April Pitman apitman@iasb.org.uk

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

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Model summary from last meeting

Recognition

- Accounting for the rights & obligations in a contract
  - performance obligations are the promises to transfer goods and services under the contract
- Combination of rights & obligations results in a net contract asset or liability
  - rights reduce as customer pays consideration
  - performance obligations are satisfied as promised goods and services transfer to customer
- Increase in net contract position (increase in asset / decrease in liability) ➔ revenue recognition

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Model summary from last meeting

Measurement

- Rights are measured at transaction price
- This amount allocated to performance obligations
  - allocated to individual obligations on basis of stand-alone sales price of underlying good or service
- At contract inception rights = obligations, so contract reported at net nil
- No revenue recognised at inception

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Changes to recognition model

- Revenue is recognised as performance obligations satisfied
- Satisfied when the good or service transfers to the customer
- Transfer based on when the customer obtains the enforceable rights to the asset
- Present practice
  - IAS 18 recognises revenue on the sale of goods on delivery
  - IAS 11, and IAS 18 for services, recognises revenue based on entity's performance

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Proposed recognition model

Good

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

Service

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

Revenue reflects transfer (ie delivery) to customer not activity of entity

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When do resources transfer in a construction contract?

Homebuilder contracts with Customer to construct a house in accordance with features and designs chosen by Customer.

- Contract for a house (ie good) or for construction services and materials (ie service & goods)?
  - depends on when economic resources transfer
  - ie does customer have rights to part complete house or only completed house?
- No revenue recognised until the end of the contract, unless resources continuously transfer
- Similar to IFRIC 15 on real estate

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Effect on present practice

- No change for many transactions
- But accounting for the *contract*, so revenue is recognised on transfer of resources to customer, not on entity's activity
  - no transfer of resource, no revenue
  - no revenue during construction or manufacturing phase for some IAS 11 contracts where entity does not transfer WIP to customer

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Recognition

Do you agree with the boards' proposal to base revenue recognition on changes in the net contract asset or liability? Are there types of contracts for which this principle is not useful?

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More unbundling within contracts

- Unbundled even when not separately negotiated or capable of rejection – IAS 11 separation criteria
- No need to unbundle all performance obligations, only if goods & services transfer at different times
  - even so, more identification of individual performance obligations within complex contracts
- Each obligation allocated part of transaction price, based on (estimated) stand-alone sales price
  - so total margin not recognised evenly over whole contract
- How to price individual performance obligations?

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Separate performance obligations

The increased unbundling in complex contracts aims to depict the transfer of resources more clearly. Do you foresee any practical difficulties with unbundling?

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Subsequent measurement

- Generally no need to remeasure performance obligations at each reporting date
  - changes in prices and circumstances typically not significant
  - initial measurement still a useful depiction of the obligation at subsequent reporting date
- Remeasure by exception when onerous
- But when is a performance obligation onerous and how should it be remeasured?

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Onerous test – main options

	Cost approach	Current price approach
Remeasurement trigger	When entity's cost of performance > carrying amount of performance obligation	When IAS 37 measurement of performance obligation > carrying amount of performance obligation
Remeasurement	Entity's expected cost of performance	Amount in accordance with IAS 37, ie including a *margin*

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Onerous test example

On 1 January 2008, ConstructorCo enters into a two-year construction contract. Customer prepays the contract price of €100,000. The construction services and materials transfer to the customer evenly over the two years. Hence, the amount of the transaction price allocated to the performance obligations satisfied in 2008 and 2009 is the same, €50,000.

At contract inception, the expected costs to fulfill the contract are €80,000, so the margin implied by the transaction price is €20,000. At 31 December 2008 the expected costs for 2009 have increased by €11,000 to €51,000, so that the performance obligation is deemed onerous both under a cost trigger and a current price/IAS 37 trigger. At 31 December 2008, the IAS 37 measure is €59,000.

Onerous test example (cont'd)

	Remeasured to cost		Remeasured to IAS 37	
	2008	2009	2008	2009
Revenue	50	50	50	50
Remeasurement gains/(losses)	(1)	1	(9)	9
Expenses	(40)	(51)	(40)	(51)
Margin	9	-	1	8
Carrying amount of performance obligation	51	-	59	-

Close vote of IASB in favour of cost approach

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Concerns about remeasuring performance obligations only when onerous

- Remeasurement by exception - entity may not identify changes in circumstances
- One-way test - reflects only some unfavorable changes
- Fails to report all changes as they arise
  - doesn't reflect uncertainty; volatility; long-term risks
  - diminishes decision-usefulness
- Inconsistency with IAS 37 and asset impairment tests

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Subsequent measurement

Do you think there are some types of performance obligations that should be remeasured at each financial statement date rather than only when onerous? If so, what are the characteristics of these obligations?

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