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

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: **February 2009, London**

Project: **Revenue recognition**
(Agenda paper 3A)

International Financial Reporting Standards

Revenue recognition

IASB's joint project with the FASB

ARG February 2009

Agenda paper 3A

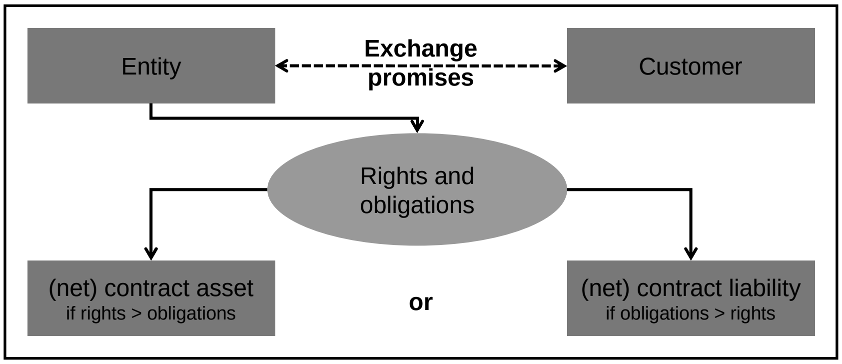
The views expressed in this presentation are those of the presenter,
not necessarily those of the IASC Foundation, the IASB or the FASB

Project background

- Objective is to develop a single, principles-based model to deal with all types of contracts and business sectors consistently
- Model based on changes in assets and liabilities
  - Change in asset or liability gives a clearer decision
  - Doesn't downgrade P&L
- Currently a number of models
  - Revenue recognition driven eg by cash, WIP
  - Each consistent with the framework
- Proposed model accounts for the position in the contract

What does the model account for?

- Contract asset or contract liability



- **Not** assets to be transferred to customer under contract (eg inventory)

Examples of the net contract position

Case 1: customer pays at contract inception, company to deliver in 60 days. Net contract position before delivery?
Remaining performance obligation but no remaining rights - contract liability

Case 2: customer to pay 60 days after delivery. Net contract position after delivery?
No remaining performance obligation but rights unchanged - contract asset

How does a contract position change?

5

- 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

Rights → Cash

Obligations → Revenue

Key principle - revenue arises from an increase in the net contract position

When is revenue recognised?

6

- When company satisfies a performance obligation
- A **performance obligation** is a promise to transfer an asset (such as a good or a service) to the customer
- A performance obligation can be satisfied only by transferring the promised good or service to the customer

Revenue reflects transfer of goods and services to customer not activities of entity in fulfilling contract

When are performance obligations satisfied?

Good

- when customer controls good (ie when good is customer's asset)
- eg sale of a widget – typically on delivery

Service

- when customer has received service
- eg warranty – as service of warranty coverage provided

How much revenue is recognised?

- Total contract revenue = transaction price
- Contract is split into performance obligations
- Transaction price allocated to performance obligations in proportion to standalone selling prices
  - standalone selling prices estimated if not observable
- When a performance obligation is satisfied, revenue recognised in the amount of the transaction price allocated to that performance obligation

How is a contract remeasured?

- Generally no need to remeasure
- Remeasure onerous performance obligations
  - **Test**: do the expected costs to satisfy exceed carrying amount of the performance obligation?
  - **Remeasurement**: measure at expected costs and recognise a contract loss
- Some performance obligations may need to be remeasured (other than when deemed onerous) to reflect changes in circumstances

Discussion points

© 2008 IASC Foundation. 30 Cannon Street | London EC4M 6XH | UK. www.iasb.org

Effect on current practice - recognition

- No change for many transactions
- Recognition
  - no revenue during construction phase for some IAS 11 SOP 81-1 contracts
  - no transfer; no revenue
  - will not be based on percentage of completion of activity, but pattern of transfer of goods and services to the customer
  - some contracts will come out of POC / project accounting

When do assets 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 the house transfers
  - 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

Effect on current practice - recognition

- Contract terms should clarify:
  - building on customer's land suggests customer controls asset as built
  - bespoke manufacturing contracts using customer's IPR often transfer control to customer eg defence; pharmaceuticals
  - POC may still be appropriate if it gives a good depiction of pattern of transfer of goods and services
- No revenue unless performance obligation satisfied
  - no revenue to cover contract origination activities
  - costs capitalised only if eligible under existing standards

Effect on current practice - unbundling

- Unbundling
  - – Revenue attributed to all performance obligations
    - – Sell a piece of equipment – warranty is a separate performance obligation
    - – Many "cost accruals" will come out of IAS 37 to revenue
  - – Use of estimates when separating obligations better reflects transfer of goods and services
    - – NB EITF 00-21 and SOP 97-2!
  - – More unbundling generally in construction contracts?

Example of increased unbundling

BuilderCo contracts with a customer to build a retirement bungalow on the customer's own site. The design consists of a square front section divided by stud walls into bedrooms and a living room; the rear section will be split equally between a conservatory and a fully fitted kitchen. BuilderCo will build the entire house for CU 125k. Expected costs are CU 105k. The contract progresses:
31 March bungalow living space complete - cumulative costs CU85k
30 June conservatory complete - cumulative costs CU 97K (expected costs increase to CU110k)
30 September kitchen complete - cumulative costs CU 117k

Current cumulative accounting - POC:

	Revenue	Costs	Margin
At March 85/105	101	85	16
At June 97/110	110	97	3
At Sept 100%	125	117	8

Example of increased unbundling

Proposed model:

BuilderCo identifies the house, the conservatory and the kitchen each as separate performance obligations. He estimates that his price is split CU90k for the house, CU15k for the conservatory and CU20k for the kitchen. He allocates that consideration to each performance obligation at inception:

Proposed accounting:

	Revenue	Costs	Margin
At March (house)	90	85	5
At June (conservatory)	105	97	8
At Sept 100%	125	117	8

Comment period ends 19 June 2009

Staff contacts:

Henry Rees (Senior project manager) hrees@iasb.org
Kenny Bement (Project Manager) kbbement@fasb.org
April Pitman (Project Manager) apitman@iasb.org
Luci Wright (Project Manager) lwright@iasb.org

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