



**International
Accounting Standards
Board**

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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

GPF Meeting: *March 2009, London*

Project: *Revenue recognition
(Agenda Paper 7)*



Revenue recognition

IASB's joint project with the FASB

Global preparers March 2009
Agenda paper 7

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Model summary

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- Accounting for the contract with a customer
- Performance obligations are satisfied when good or service transfers to the customer
- Net contract position increases – revenue is recognised
- Sum of performance obligations = transaction price
- Revenue recognised at transaction price allocated to each performance obligation at inception

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Case studies

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Discuss:

When does transfer take place for each?

How is transaction price allocated to individual performance obligations in the examples discussed?



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Recognition – performance obligation satisfied by transfer to the customer

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- No transfer; no revenue
- Accounting for the contract
 - consider actual contract terms and legal jurisdiction
- Who owns WIP? Do the terms of contracts specifically transfer the WIP to the customer as constructed?
 - Some assets may transfer continuously if on customer's land or using customer's know-how, e.g. extension to customer's house is the customer's asset throughout
 - Percentage of completion will only apply where the asset transfers continuously and it reflects that pattern of transfer
 - System considerations – where currently tracking cost, not satisfaction of components

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Recognition - extended notion of 'transfer'

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- The DP considers the effect of:
 - customisation
 - acceptance
 - payment terms
- How much guidance is needed?
- If revenue cannot be recognised:
 - does it matter if costs held as inventory? – no loss
 - lumpy profits where entity has a few large contracts



Case study 1 – constructing a submarine for a customer

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Shipbuilder contracts with Defence Agency to construct a submarine. The keel and bulkheads of the ship will take 9 months to complete; the internal fit-out 6 months. Sea trials will take 3 months. The price of the submarine is CU 400m and costs are:

| | |
|--------------------------------|------|
| Keel | 50m |
| Other structures | 100m |
| Internal fit out and equipment | 150m |
| Sea trial costs | 5m |

The customer inspects the ship, signs acceptances and pays budgeted cost plus 10% at each successful stage. The final payment of CU64.5m is paid 30 days after completion of sea trials.



Case study 2 – Accounting for an energy plant

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EngineeringCo contracts with UtilityCo to construct a power station. It is specially designed for that customer, but design is controlled by EngineeringCo who has the specialist knowledge required. The price is CU 750 m. Construction takes place at two principal sites – EngineeringCo's machine shop where plant such as turbines are constructed and also at the customer's designated site for the energy plant where the engine halls and cooling towers are constructed prior to installation of the generating equipment. The cost of the plant and equipment is CU 350m and the power station building CU 250m. It is a turn-key project -EngineeringCo install and test the completed plant; the customer has specified rejection clauses and terms.



Use of estimated sales price

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- Estimation of bundle sales prices will significantly change aspects of US GAAP
 - EITF 00-21 and EITF 08-1 - multiple deliverables
 - SOP97-2 – software (VSOE affected)
 - EITF 08-9 – milestone method
 - Recognition is not delayed for components lacking observable evidence of a sales price
 - Would the use of estimated selling price for some performance obligations be suitable for all contracts?
 - SOP 97-2 re software used to 'rein-in' sales teams?



Case study 3 – Accounting for a software product with post-delivery services

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SoftwareCo provides Customer with an application to run its payroll. The package includes the application itself, access to a help line for the next year and a promise to upgrade the software should any changes to payroll taxes come into effect. The total selling price of this package is CU 850. SoftwareCo never sells the application without the help desk and tax patches, but it does sell subsequent years of combined helpline support and upgrades at CU 100 pa.



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