Project **Revenue Recognition**

Topic **Disclosure**

Objective

1. The objective of this meeting is for the boards to decide what revenue disclosures to propose in the forthcoming exposure draft.

2. In developing this disclosure package the staff's approach has been:

    (a) to consider disclosure requirements in the context of the financial statements as a whole;

    (b) to limit redundancy/overlap with revenue disclosure requirements in other standards;

    (c) to consider the relevance of current disclosure requirements and whether they should be retained;

    (d) to justify inclusion of disclosures incremental to current requirements and ensure they do not overburden financial statement users or preparers; and

    (e) to consider whether the revenue standard is the appropriate place for recommended disclosures.

Summary of staff recommendations

3. The staff recommends the following:

    (a) setting high level disclosure objectives (paragraphs 14–18)

(b) requiring an entity to describe the nature of contracts it enters into with customers and the related accounting policies (paragraphs 19–26)

(c) requiring a reconciliation of the beginning and ending net contract position(s) and beginning and ending additional liability recognised for onerous contracts (paragraphs 27–41)

(d) using a principle-based approach:

   (i) for the disaggregation of revenue recognised and other revenue related disclosures (paragraphs 42–53)

   (ii) for the disclosure of principal assumptions and estimates used in accounting for contracts with customers and the effect of changes in assumptions and estimates (paragraphs 54–78)

   (iii) for the disclosure of risk (paragraphs 79–87).

A draft of the proposed disclosures based on the staff recommendations is set out in Agenda Paper 4B/Memo 125B as a guide, however the specific words are subject to change.

Background

4. This section discusses the following:

   (a) Scope (paragraphs 5-6)

   (b) Research sources (paragraph 7)

   (c) Materiality (paragraphs 9-10)

   (d) Disclosure framework (paragraphs 11-13).

Scope

5. The disclosures the staff is considering for the revenue recognition exposure draft will be limited to those required in the financial statements. That is, the staff is not considering management commentary. The IASB discussion paper

Management Commentary describes disclosures within the scope of financial statements as follows:

> Information that disaggregates or expands on the elements present in the primary financial statements or explains how the information has been defined or measured is the province of the notes. This will include information about the accounting policies used to measure elements or the judgements made in making estimates relating to elements in the financial statements.

6. Although the revenue recognition project addresses only revenue, staff discussions with users indicate that some think that revenue disclosures should also include information about the costs associated with that revenue, in order to provide information about the margin. Because the boards have decided that accounting for costs is beyond the scope of the revenue project, the staff has not analysed possible disclosures related to cost or linking revenue recognition disclosures to other items in the financial statements.

Research sources

7. In developing the recommendations the staff has:

    (a) considered the responses received on the boards' Discussion Paper *Preliminary Views on Revenue Recognition in Contracts with Customers*[1]

    (b) considered the FASB's Investor Technical Advisory Committee (ITAC) proposed[2] 'principles-based' disclosure framework (ITAC Disclosure Framework) and the Canadian Accounting Standards Board's draft Framework for the disclosure of information in financial statements

    (c) considered the disclosures required by the recently finalised EITF Issue No. 08-1 *Revenue Arrangements with Multiple Deliverables* and the feedback received from preparers and users (the Disclosure Group) in

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[1] Although the discussion paper did not include any preliminary views or invitation to comment on revenue disclosures, over 30 respondents discussed disclosure issues

[2] In ITAC's December 2007 letter to the FASB

developing the disclosure requirements of EITF 08-1 (US Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Section 605-25-50 *Multiple Element Arrangements-Disclosure*)

(d) consulted:

   (i) members of the IASB's Analyst Representative Group (ARG), of the Corporate Reporting Users Forum and of the ITAC through a questionnaire and meetings

   (ii) members of the joint ARG and Global Preparers Forum at their 10 November 2009 meeting.

Materiality

8. Feedback received from users indicates two issues relating to materiality:

   (a) The disclosure of information required by a specific standard even when the information is immaterial unnecessarily clutters the financial statements.

   (b) The nondisclosure of material information if such information is not specifically required.

9. Some IFRS literature relating to disclosure includes guidance on materiality (such as IFRS 7 *Financial Instruments: Disclosure* and ED 10 *Consolidated Financial Statements*). For instance, IFRS 7 paragraph B3 states:

> An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this IFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, a reporting entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, a reporting entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.

10. However the recent thinking of the IASB when considering improving disclosures for IAS 19 *Employee Benefits* indicates that materiality as defined in

IAS 1 *Presentation of Financial Statements* is sufficient and additional guidance should not be required in each standard. Consequently the staff does not recommend including guidance on the application of materiality to the disclosures.

Disclosure framework

11. Many users highlighted the importance of appropriate disclosure to accompany the new revenue recognition model. Such disclosure should be concise and relevant while complementing the communication of the entity's performance. Feedback from both regulators and users indicates that today's revenue disclosures are inadequate and lack cohesion with disclosure of other elements in the financial statements.

12. Existing standards provide little guidance on general disclosure principles that can be used when developing specific disclosures. However, other projects that are considering general disclosure principles include the FASB Disclosure Framework project and the Financial Statement Presentation project. In these and other projects on the boards' agendas that are considering amendments to disclosure, apart from considering the views of users and preparers, project teams have looked to the ITAC Disclosure Framework.

13. Therefore, in structuring the analysis, the staff has tried to follow the broad categories of the ITAC Disclosure Framework:

    (a) General

        (i) Disclosure objectives (paragraphs 14–18)

        (ii) Nature of revenue and accounting policies (paragraphs 19–25)

    (b) Composition

        (i) Roll-forward (paragraphs 27–41)

        (ii) Disaggregation (paragraphs 42–53)

    (c) Assumptions and uncertainties

(i) Principal assumptions and estimates used and changes in assumptions and estimates (paragraphs 54–78)

(ii) Risks (paragraphs 79–87).

Staff analysis

Disclosure objectives

14. Current IFRSs dealing with revenue do not specify clear disclosure objectives. Under US GAAP, the disclosure requirements in FASB ASC Section 605-25-50 include the following disclosure objective:

> The objective of the disclosure guidance in this Section is to provide both qualitative and quantitative information about a vendor's revenue arrangements and about the significant judgments made about the application of this Subtopic and changes in those judgments or in the application of this Subtopic that may significantly affect the timing or amount of revenue recognition.

15. IFRS 7 and IFRS 4 *Insurance Contracts*—two more recent standards dealing with contracts—include disclosure objectives requiring entities to identify and explain amounts recognised and to provide information that allows users to evaluate the associated risks.

16. The staff believes a disclosure objective is required in order to meet the disclosure requirements of users (such as information on composition, uncertainty and risk as specified in the ITAC Framework) and to provide a basis for developing more specific disclosure requirements. The objective in FASB ASC Section 605-25-50 appears clearer in terms of requiring both qualitative and quantitative disclosures and disclosures about the effect of judgement on the amount and timing of revenue recognised while the IFRS 7 objectives also require disclosure of risks. Part of the disclosure objective in FASB ASC Section 605-25-50 relates specifically to the use of judgement and the effect of changes in judgement. The staff considers these further below in paragraphs 54–78.

17. The staff recommends aligning the revenue disclosure objective with the objectives in FASB ASC Section 605-25-50 and IFRS 7. The staff envisages an objective along the following lines:

    An entity shall disclose quantitative and qualitative information that:

    (a) identifies and explains the amounts recognised in its financial statements arising from contracts with customers; and

    (b) enables users of its financial statements to evaluate the nature and extent of risks arising from contracts with customers, and how the entity manages those risks

18. Although the above disclosure objective is broad, in the staff's view:

    (a) it meets users' needs and addresses the requirements in the ITAC Framework

    (b) it provides a framework from which to develop specific disclosures; and

    (c) provides preparers and auditors with a general guideline for assessing whether the overall quality and informational value of the disclosure sufficiently meets the stated objectives.

Question 1
Do the boards agree to set a high-level revenue recognition disclosure objective similar to the objectives in IFRS 7 and FASB ASC Section 605-25-50?

Nature of, and accounting policies applicable to, contracts with customers

19. If an entity properly discloses its accounting policies, a user will be better able to understand and evaluate the financial statements in order to make investment decisions. Currently, both US GAAP and IFRSs require an entity to disclose its accounting policies for recognising revenue in its financial statements:

    (a) IAS 1 *Presentation of Financial Statements* paragraph 10(e) states that a complete set of financial statements includes a summary of significant accounting policies. Paragraphs 117 to 124 provide general guidance for the disclosure of accounting policies.

(b) FASB ASC Section 235-10-50 *Notes to Financial Statements-Disclosures* requires the disclosure of accounting policies used and provides general guidance for these disclosures in FASB ASC paragraphs 235-10-50-1 to 235-10-50-6.

20. The staff believes that the above general accounting policy disclosure requirements should, if properly applied, result in disclosures that sufficiently enable a user to understand how an entity has recognised and measured revenue related balances during the period. Therefore there is no need for a specific requirement in the revenue recognition standard similar to the redundant requirement in IAS 18 *Revenue* to disclose the accounting policy for revenue recognition.

21. However, users have highlighted two issues with how these general requirements are being implemented by entities:

(a) use of judgements

(b) nature of contracts.

Use of judgements

22. Disclosure of these accounting policies relating to revenue are frequently considered to be inadequate because they do not provide enough information on the specific bases, conventions, rules or practices to allow a user to understand the level of judgement made in preparing the financial statements nor to allow the user to verify the quality of that judgement. Constituents have commented that disclosures concerning the judgements made are often too “boilerplate”, generic, or superficial to be useful. The staff considers disclosures related to judgements further in paragraphs 54–78.

Nature of contracts

23. Users have also noted that financial statements are deficient because entities do not currently disclose the nature of the contracts entered into with customers and

how they reflect these in their accounting policies. In particular, the accounting policies currently stated do not usually disclose an entity's contractual terms with its customer in sufficient detail to enable users to understand that entity's basis for accounting for its contract with customers and for recognising revenue.

24. When considering the disclosure requirements of EITF 08-1, Disclosure Group members noted that the requirement for an entity to disclose its accounting policy for the recognition of revenue from multiple-deliverable arrangements generally results in the entity simply reciting some language from the standard. The Disclosure Group agreed instead that an entity should disclose the nature of its multiple-deliverable arrangements, including a description of the arrangements, how an entity identifies deliverables within the arrangements, and performance-, cancellation-, termination-, and refund-type terms. Another common theme in feedback received from users is a requirement for an entity to identify unusual or non-recurring transactions.

25. The staff agrees with users and the conclusions reached by the Disclosure Group that any disclosure about accounting policies should describe the types of contracts with customers an entity typically enters into; the underlying goods and services; the typical timing of satisfaction of performance obligations; significant contract terms; and whether it is acting as principal or agent. As important as disclosing what its policies are is a description of how these policies reflect the nature and terms of contracts with customers.

26. The staff has considered whether to require disclosure of significant contracts entered into under non-standard contract terms or that are non-recurring. However, if the boards require an entity to aggregate the disclosure of the nature of its contracts based on categories of significant goods or services, the staff believes that any significant contract entered into under non-standard terms would fall into its own category, thus requiring disclosure. In addition, an entity would be required to identify other material amounts necessary to a user's understanding of performance under existing general requirements under IFRSs (eg IAS 1) and US GAAP.

Question 2
Do the boards agree that an entity should disclose the nature of its contracts with customers, including a general description of the significant goods and services categories underlying its performance obligations, highlighting for each: (a) the typical timing of satisfaction of performance obligations and, hence, the typical timing of revenue recognition, (b) the significant terms including payment, cancellation, returns, and refunds included in contracts with customers; and (c) whether it is acting as principal or agent. (Agenda Paper 4B/Memo 125B paragraph 5)

Linking performance with financial position

27. Many users complain that entities report revenue in isolation, ie users cannot relate revenue to the entity's financial position. At present an entity recognises a number of working capital balances such as trade receivables and deferred revenue at each reporting date but their relationship to the revenue recognised in the period is unclear.

Roll-forward of net contract position

28. Because the proposed model focuses on the accounting for the contract, an entity could roll-forward movements of the net contract asset or liability in the notes to the financial statements, placing revenue in the income statement in the context of the opening and closing financial position.

29. The boards could specify that an entity present the roll-forward either gross or net. Under a gross basis an entity would present a roll-forward of rights and performance obligations in separate columns with a total net figure that links with the statement of financial position. For example:

	Gross		Net
CU000s	**Rights**	**Obligations**	**Contract position**
Opening carrying amount 2009	36,990	-39,867	-2,877
Changes in estimates	-381	703	322
New contracts obtained	61,223	-61,223	-
Variations to existing contracts agreed in advance	1,256	-1,256	-
Rights to consideration transferred to receivables	-42,134	-	-42,134
Revenue recognised related to performance in current period	-	37,562	37,562
Contracts acquired in business combinations	1,000	-754	246
Closing carrying amount 2009	**57,954**	**-64,835**	**-6,881**

30. This gross roll-forward of the rights and obligations would in effect link the order book with revenue recognised. In particular, it would highlight the amount of new contracts obtained and the amount of unsatisfied performance obligations and, hence, indicate the amount of revenue expected to be recognised in the future as a result of contracts that already exist. This would allow users of the financial statements to assess the reported revenue in the context of the entity's trading position as a whole.

31. However the disadvantages of requiring a roll-forward on a gross basis are:

    (a) the high cost of providing this information, because an entity would be required to measure all unperformed contracts, which would include making estimates of uncertain consideration.

    (b) the additional costs of auditing these amounts as they are not currently required to be audited.

    (c) the high level of uncertainty inherent in unexecuted contracts.

32. In the staff's view, these disadvantages would also apply to partially completed contracts (ie an entity would be required to measure the total consideration including uncertain consideration in order to allocate an amount to the performance obligation satisfied).

33. While feedback has indicated that most users are in favour of gross presentation of the roll-forward, some users have indicated that they are comfortable with disclosures relating to the order book remaining within the domain of management commentary if gross presentation was not operational.

34. The staff also considered whether a roll-forward should be required for all contracts or a sub-set of contracts. Feedback from users indicates that they consider a roll-forward more useful for long-term or construction-type contracts. However, in the context of a single revenue recognition model, the staff does not believe that it would be beneficial to identify a sub-set of contracts for which a roll-forward should be required. As noted in paragraph 8, the general guidance regarding the application of materiality should be sufficient.

35. Consequently the staff recommends that the boards require a roll-forward disclosure on a net basis. The staff notes that this is consistent with the boards' tentative decision to require a roll-forward for all significant accounts in the *Financial Statement Presentation* (FSP) project.

Using the roll forward to link revenues and cash

36. One aspect that users have consistently raised is the link between revenue and cash flows. In order to evaluate potential cash inflows, users need to be aware of situations in which the satisfaction of performance obligations does not correspond with cash flows, because the entity provides financing or the customer pays in advance.

37. Users will be able to calculate cash received by comparing the amount of rights transferred to trade receivables to the beginning and closing balances of trade receivables. Previously users would have to understand various different working capital and sundry accounts (such as deferred revenue) to understand the link between working capital movements, revenue recognised and cash

received. Using the proposed model, an entity aggregates most of these working capital accounts into the net contract position and the roll-forward will provide the link between the net contract position and the remaining working capital accounts (such as receivables).

Display of changes in estimates

38. Users have asked for a disaggregation of revenue recognised during the period between amounts relating to performance in the current period and amounts relating to changes in estimates affecting amounts relating to performance in previous periods. An entity could disclose these amounts as part of the roll-forward. If presented on gross basis, the change in estimates line would disclose the change in estimates to the gross rights and performance obligations, and the amount of revenue recognised in the statement of financial performance relating to changes in estimates for performance obligations satisfied in prior periods.

Question 3
Do the boards agree that an entity should disclose a roll-forward of opening and closing balances of the net contract position? (Agenda Paper 4B/Memo 125B paragraph 8(a)).

Onerous contracts

39. The proposed model requires entities to remeasure performance obligations when they become onerous. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires a roll-forward of the liability (provision) for onerous contracts in order to explain changes in the amount of the liability recognised.

40. The staff recommends disclosures consistent with IAS 37 should be required for the additional liability for onerous contracts with customers. This will include requiring a roll-forward disclosing:

    (a) amounts recognised in the statement of comprehensive income due to:

        (i) contracts becoming onerous during the period

        (ii) contracts no longer being onerous

(iii) other adjustments to the amount of the liability (eg changes in estimates and effects of the time value of money)

(iv) amount of liability satisfied during the period

Question 4
Do the boards agree that an entity should disclose a roll-forward of opening and closing balances of the additional liability for onerous contracts? (Agenda Paper 4B/Memo 125B paragraphs 8(b))

Balances in other items of the statement of financial position related to contracts with customers

41. As noted in paragraph 37, the staff's proposed roll-forward includes disclosure of amounts transferred to other balance sheet items such as receivables. In order to complete the link to other items in the financial statements, disclosures of amounts within those balances relating to revenue will be required. IAS 1 paragraph 78 requires further subclassifications in the notes depending on the requirements of other IFRSs and on the size, nature and function of the amounts involved. In order to ensure consistency between IFRS and US GAAP, the staff recommends the boards require disclosure of amounts in other items in the statement of financial position arising from contracts with customers.

Question 5
Do the boards agree that an entity should disclose the amounts in other items in the statement of financial position arising from rights and obligations in contracts with customers? (Agenda Paper 4B/Memo 125B paragraph 8(c))

Disaggregation

42. Financial statements present information at an aggregated level for clarity and ease of understanding. Users need disaggregation to fully understand and interpret the components of this summary information in the financial statements. Effective disaggregation should allow enhanced comparability and understanding of the amounts involved.

43. This section discusses the following:

    (a) Disaggregation of revenue recognised in the income statement (paragraphs 44–49)

    (b) Disaggregation of other revenue related disclosures (paragraphs 50–53).

Disaggregation of revenue recognised in the income statement

44. Much of the feedback received from users suggests that a key disclosure requirement is a meaningful disaggregation of revenue recognised during the period. Feedback from users indicates that they think the most useful disaggregations are by business segment, deliverable or geography. However users highlight that the level of disaggregation is important, and that information that is too aggregated loses its meaning and that information that is too granular overburdens the financial statements.

45. IAS 18 currently requires disclosure of the amount of each significant category of revenue recognised during the period, including revenue arising from:

    (a) the sale of goods;

    (b) the rendering of services;

    (c) interest;

    (d) royalties; and

    (e) dividends.

46. Both IFRS 8 *Operating Segments* and ASC Topic 280 *Segment Reporting* (formerly SFAS 131) require an entity to disclose revenue derived from each of its deliverables (or groups of deliverables) by operating segment. They also require related disclosures about the types of products and services, geographical areas and major customers.

47. When considering the disclosure requirements of EITF 08-1, the Disclosure Group discussed the level of operation at which an entity should provide the disclosure information. Some commented that entities should make the disclosure at the level of *major product type*. Several Disclosure Group

members commented that requiring disclosure at the level below the major product type could result in disclosure of proprietary information, particularly as it relates to the entity's go-to-market and pricing strategies that it uses in determining the estimated selling price. The Disclosure Group also expressed concern over the requirement to disclose information by major product type because major product type is not a defined term. The Disclosure Group discussed the possibility of defining major product type to be consistent with existing requirements in ASC Topic 280. However, the general view among Disclosure Group members was that disclosure at that level may not result in sufficiently granular disclosures. Rather the Disclosure Group agreed that a more useful requirement would be to disclose information regarding similarly bundled arrangements (contracts that bundle goods and services in a similar fashion). Members of the Disclosure Group generally believed that disclosures at this level would provide more useful information to users of the financial statements regarding the vendor's operations and how management evaluates its multiple-deliverable arrangements.

48. The staff believes that the nature of an entity's contracts with customers should drive the disaggregation of revenue recognised during the year. There should be a clear link between the narrative explaining the nature of contracts with customers, how an entity reflects this in the application of the proposed model and the revenue recognised during the year. The staff believes that this would be consistent with the conclusion of the Disclosure Group as the nature of contracts with customers would include similarly bundled arrangements. These amounts can then be analysed by operating segment as required by IFRS 8 and ASC Topic 280.

49. Therefore the staff recommends that an entity disclose revenue recognised during the year for each category of significant goods and services identified in its accounting policies (ie as discussed in paragraphs 19–25). Also, in order to improve the interaction of the proposed revenue standard with current standards on segment reporting, the staff recommends that consequential amendments are made to IFRS 8 and ASC Topic 280 to require revenue within operating segments to be disaggregated the same way.

Questions 6 and 7
Do the boards agree that an entity should disclose revenue recognised during the year for each category of significant goods and services identified in its accounting policies? (Agenda Paper 4B/Memo 125B paragraph 6) Do the boards agree that IFRS 8 and FASB ASC Topic 280 should be amended to require revenue recognised to be disaggregated in the same way as the above? (Agenda Paper 4B/Memo 125B paragraph 7)

Disaggregation of other revenue related disclosures

50. The other disclosures related to revenue include the other recommendations in this paper, such as the roll-forward and disclosures of estimates and judgements used. The staff would like entities to provide users of financial statements with a meaningful disaggregation of this information to facilitate their analysis.

51. The staff sees the following alternatives for disaggregating other revenue related disclosure:

    (a) Require disaggregation by operating segment as required in IFRS 8 and ASC Topic 280,

    (b) Require disaggregation based on the recommendation in question 6 or

    (c) Require disaggregation based on what would be most useful in meeting the objectives specified in paragraph 17, suggesting that disaggregation based on (a) or (b) above might be useful.

52. The staff thinks that prescribing an appropriate level of disaggregation may be difficult because a specified disaggregation for one disclosure, say the roll-forward, may not be the most meaningful disaggregation for another disclosure such as risk. In addition having different specified disaggregation requirements for different disclosures would increase the burden on preparers.

53. Therefore, the staff recommends that an entity should be required to disaggregate other disclosures based on what would be most useful in meeting the disclosure objectives. The staff believes this is a more principle-based approach. As indicated above, the staff believes it would be useful to suggest that a disaggregation in accordance with IFRS 8 and ASC Topic 280 or by the

nature of goods and services identified may meet this principle. This alternative is similar to the requirement in IAS 19, except that IAS 19 does not require disaggregation by operating segment.

Question 8
Do the boards agree that an entity should disaggregate revenue disclosures based on what would be most useful in meeting the disclosure objectives? (Agenda Paper 4B/Memo 125B paragraph 4)

Extent of judgement exercised

General

54. An entity is required to exercise judgement in applying the proposed model, including the following areas:

    (a) allocating total contract consideration to contract segments or individual performance obligations based on standalone selling price

    (b) estimating the total contract consideration, especially for uncertain and non-cash consideration

    (c) determining when control is transferred (timing of satisfaction of performance obligation)

    (d) determining the amount of the additional liability for onerous contracts.

    (e) estimating returns and warranties.

55. A user will need to assess these judgements made by management under the proposed model. Therefore, disclosure will be necessary to provide users of financial statements with information about the judgement exercised in recognising and measuring amounts included in the financial statements.

56. Currently there are no specific disclosure requirements regarding the use of estimates in IAS 18. As previously mentioned, EITF 08-1 includes an objective and several specific requirements relating to the estimates used when accounting for multiple-element arrangements. Both IFRSs and US GAAP have other general requirements regarding the disclosure of significant accounting estimates and judgements made. These disclosures include:

(a) IAS 8 paragraph 39:

> An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.

(b) IAS 1 paragraph 122:

> An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

(c) IAS 1 paragraph 125:

> An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:
>
> (a) their nature, and
>
> (b) their carrying amount as at the end of the reporting period.

(d) FASB ASC paragraph 250-10-50-4 *Accounting Changes and Error Corrections*:

> The effect on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), and any related per-share amounts of the current period shall be disclosed for a change in estimate that affects several future periods, such as a change in service lives of depreciable assets. Disclosure of those effects is not necessary for estimates made each period in the ordinary course of accounting for items such as uncollectible accounts or inventory obsolescence; however, disclosure is required if the effect of a change in the estimate is material. When an entity effects a change in estimate by changing an accounting principle, the disclosures required by paragraphs 250-10-50-1 through 50-3 also are required. If a change in estimate does not have a material effect in the period of change but is reasonably certain to have a material effect in later periods, a description of that change in estimate shall be disclosed whenever the financial statements of the period of change are presented.

57. However the staff believes that specific disclosures should be required because these general requirements might not address specific aspects of the proposed

model and therefore might lead to divergent application under US GAAP and IFRS.

58. The Disclosure Group identified similar judgements requiring disclosure to those identified in paragraph 54 above, including the process for identifying deliverables, the timing and pattern of revenue recognition for the significant deliverables, and the judgements involved in determining selling price.

59. Based on the above, the Disclosure Group generally agreed with the following disclosure objective, which was then adopted as part of FASB ASC Section 605-25-50:

> The objective of the disclosure guidance in this Section is to provide both qualitative and quantitative information about a vendor's revenue arrangements and about the significant judgments made about the application of this Subtopic and changes in those judgments or in the application of this Subtopic that may significantly affect the timing or amount of revenue recognition.

60. The staff recommends setting a similar principle for the disclosure of significant judgements made in applying the proposed model.

Question 9
Do the boards agree to align the disclosure principle for significant judgements with the objective in FASB ASC Section 605-25-50? (Agenda Paper 4B/Memo 125B paragraph 9)

Allocating consideration based on standalone selling price

61. To meet the objective in question 9, an entity would need to disclose information that enables users of the financial statements to understand how an entity allocates the customer consideration amount to performance obligation at inception. This would include:

(a) identification of individual performance obligations;

(b) aggregation of performance obligations into contract segments; and

(c) estimation of standalone selling prices.

62. The requirement to allocate consideration based on standalone selling price is very similar to the requirement in EITF 08-1 for allocation based on *estimated*

selling price (ESP). In developing EITF 08-1 the Task Force undertook extensive outreach to develop disclosures to communicate the judgements used in determining ESP and their effect on revenue recognition.

63. The Disclosure Group noted that changes in a vendor's ESP could affect the allocation under EITF 08-1 and resulting timing of revenue recognition. As a result, the Disclosure Group considered it important that the disclosure requirements include information regarding any significant changes in the estimated selling price or changes in the method used to determine selling price and the resulting effect on the timing or pattern of revenue recognition.

64. The Disclosure Group also noted that some constituents may be concerned that the determination of ESP may be more subjective than selling price determined using vendor specific objective evidence or third party evidence, and therefore believe that ESP may be more susceptible to bias or error. As a result, these same constituents believe that it is more likely that an entity may allocate consideration inappropriately using ESP than using vendor specific objective evidence or third party evidence.

65. Comments received from analysts and presented at the Disclosure Group further supported the view that ESP may be more susceptible to bias or error. Overall, analysts suggested that the objective of EITF 08-1 disclosures should be to help analysts understand the extent to which management judgements affect revenue recognition. Analysts indicated that they want to know why third-party evidence of selling price and ESP are used, how they are used, and their effect on revenue recognition. In essence, analysts want to know if management judgements are reasonable.

66. Based on the above, the final requirements adopted in FASB ASC Section 605-25-50 included the following:

> A vendor shall disclose all of the following information by similar type of arrangement:
>
> …
>
> (e) A discussion of the significant factors, inputs, assumptions, and methods used to determine selling price (whether vendor-specific objective evidence, third-party

evidence, or estimated selling price) for the significant deliverables

(f) Whether the significant deliverables in the arrangements qualify as separate units of accounting, and the reasons that they do not qualify as separate units of accounting, if applicable

(g) The general timing of revenue recognition for significant units of accounting

(h) Separately, the effect of changes in either the selling price or the method or assumptions used to determine selling price for a specific unit of accounting if either one of those changes has a significant effect on the allocation of arrangement consideration.

67. The staff believes that the conclusions of the Disclosure Group regarding disclosure of judgements used when applying EITF 08-1 can be applied more generally to all judgements in the proposed model including the judgments identified below. Similarly to the staff's suggested adaption of the disclosure objective, the staff suggests adapting and generalising the specific requirements of EITF 08-1 to the judgements identified in paragraph 54. The staff's recommendation is detailed in question 10 and 11.

Estimating total contract consideration

68. To meet the objective in question 9, an entity would need to disclose information that enables users of the financial statements to understand the extent of judgement exercised by management in estimating the total contract consideration. This would include estimating the value of contingent consideration and non-cash consideration.

69. The Disclosure Group did not consider these factors as they were beyond the scope of EITF 08-1, however the staff believes that many of the concerns raised above regarding the estimation of standalone selling price would also apply to the determination of total contract consideration. However, uncertain consideration and non-cash consideration will only affect the amounts recognised if an entity has satisfied some of the performance obligations. Therefore the staff recommends adapting the disclosures recommended by the

Disclosure Group to the estimation of total contract consideration where the entity has satisfied some of the performance obligations.

Determining performance

70. Under the proposed model, an entity is required to identify a measure of performance when bundling groups of performance obligations into contract segments.

71. To meet the objective in question 9, an entity should disclose the measure used to determine performance for contract segments and why it considers such a measure a suitable estimate for transfer of goods and services. This disclosure should include whether it uses output-related measures or input related measures.

Onerous contracts

72. Under the proposed model, an entity should recognise a liability and a corresponding contract loss for an onerous contract segment in the amount by which the expected costs to satisfy the remaining performance obligations in that contract segment exceed the amount of the transaction price allocated to those performance obligations.

73. Disclosure about onerous contracts should provide information to enable users to assess the basis of calculation and adequacy of any liability recognised. The staff believes that the disclosure of the significant factors, inputs, assumptions and methods used to estimate the amount of the additional liability for onerous contracts would meet users' requirements and be consistent with the disclosures required by IAS 37.

Other judgements

74. An entity should give an indication of the degree of judgement exercised in accounting for other contract terms, by detailing the circumstances when judgement is required and the basis on which an entity makes those judgements. This disclosure could draw together the contractual basis of the agreement with the estimation method by providing details of historical experience, trends and

projected conditions which affect the estimates used. Some contract terms and related circumstances where judgement is likely to be needed include:

(a) Effect of returns policy and the basis of estimating returns

(b) Warranties and guarantees terms, including the risk of failed performance

Questions 10 and 11
Do the boards agree that an entity should disclose a discussion of the significant factors, inputs, assumptions and methods used to estimate amounts arising from contracts with customers? (Agenda Paper 4B/Memo 125B paragraph 10) Do the boards agree that an entity should disclose significant changes to estimates or changes in the methods used to determine those estimates in sufficient detail to communicate the expected effect on the amount and timing of revenue recognition? (Agenda Paper 4B/Memo 125B paragraph 11)

Quantitative disclosure of estimates

75. When developing disclosures for EITF 08-1, the Disclosure Group debated whether to require some quantitative disclosure of the extent of management judgement exercised and the effect of changes in estimates.

76. Several members of the Disclosure Group believed that quantitative disclosures would not provide users with meaningful information. For example, the disclosure of revenue recognised in the period on the basis of an estimated selling price provides no information to the users as to the interaction with other units of accounting in terms of arrangement allocation or other aspects of the vendor's operations that might mitigate bias or error. Other Disclosure Group members commented that requiring a vendor to disclose quantitative information may help to ensure that vendors maximise the use of observable prices (as required by EITF 08-1), because without this incentive, vendors may no longer try to identify such prices and, instead, default to the use of ESP. Other Disclosure Group members noted that it should not be the place of the EITF to include disclosures for the sole purpose of preventing abuse. Preparers on the

Disclosure Group also indicated that there would be a high cost to comply with any quantitative disclosure requirement.

77. Many of the arguments raised by the Disclosure Group when discussing quantitative disclosures in EITF 08-1 are applicable under the proposed model. The proposed model requires entities to maximise the use of observable inputs when making the estimations discussed above. Quantitative disclosures used elsewhere in accounting literature to communicate the extent of management judgement exercised includes the three level hierarchy used in fair value measurement.

78. The staff agrees with the arguments noted by the Disclosure Group and consequently does not recommend the boards require quantitative disclosure of the extent of management judgement.

Risk

79. Current standards on revenue do not include any disclosure requirements for risks arising out of contracts with customers. Some respondents requested that the boards require disclosure about the risk inherent in contracts with customers, specifically for long-term and volatile contracts.

80. Consequently, the staff recommends additional disclosures on risks arising from contracts with customers. Risks arising from contracts with customers might include:

    (a) The risk arising from uncertainty about the ultimate amount of consideration to be received for a contract. This can be due to consideration being contingent on an entity’s future performance, or factors outside the entity’s control.

    (b) The risk that the actual timing of satisfaction of an entity’s outstanding performance obligations will differ from that expected and result in a change in the timing of revenue recognition.

    (c) An entity’s exposure to returns and warranties.

(d) An entity's exposure to changes in the price and quantity of resources required to satisfy performance obligations including when such exposures might lead to a contract becoming onerous. This risk could arise, for instance, when an entity enters into a fixed price contract for the delivery of a good with a volatile price.

81. The staff recommends an entity should be required to disclose narrative descriptions of risk exposures, risk management policies and concentrations of risk similar to the requirements of IFRS 7 and IFRS 4. For instance when an entity has entered into a long-term fixed-price contract for the construction of a building, disclosures regarding its project management or policies regarding forward procurement of materials and labour would be useful. Or in the case of an entity required to deliver a commodity, it may be appropriate to disclose whether the entity hedges its price exposure. Such disclosures will help users evaluate the nature and extent of risks arising from contracts with customers.

82. While the risk disclosures recommended are incremental to the current disclosures, these disclosures are consistent with the relevant requirements in IFRS 7 (and IFRS 4) and in response to some constituents' concerns regarding deficiencies in current requirements.

83. While the staff acknowledges the additional burden placed on preparers when applying these disclosures, the staff believes that the benefit of transparency provided to users of the underlying quality of revenue will outweigh these costs.

Questions 12

Do the boards agree that an entity should disclose information on the nature and extent of risks arising from contracts with customers? (Agenda Paper 4B/Memo 125B paragraph 12)

Do the boards agree that, for each type of risk arising from contracts with customers, an entity shall disclose:

(a) the exposures to risk and how they arise;

(b) its objectives, policies and processes for managing the risk; and

(c) any changes in (a) or (b) from the previous period.

(Agenda Paper 4B/Memo 125B paragraph 13)

Do the boards agree that an entity shall disclose any concentrations of risks not apparent from the above? (Agenda Paper 4B/Memo 125B paragraph 14)

Expected timing of satisfaction of net contract liabilities or outstanding performance obligations

84. An ageing of the contract liability is useful in that it helps users assess the risks associated with future revenues. In general, users see the outcome to be more uncertain the further out the resolution of the balance is as it will be subject to a greater number of factors and uncertainties than will a more immediately satisfied obligation. Users will also be able to compare actual revenue recognised with what was expected.

85. Depending on the boards' decision regarding whether to require a roll-forward of the gross performance obligations or the net contract position, such a disclosure of the expected timing of satisfaction can be for either any net contract liability, or the gross performance obligations.

86. If the boards decided to require a gross roll-forward, then an entity could disaggregate the expected timing of satisfaction of outstanding performance obligations in a similar manner to the maturity analysis required for leases and other long term financial liabilities. The outstanding performance obligations at the reporting date could be split between those expected to be satisfied:

    (a) within one year,

    (b) between two and five years; and

    (c) greater than five years.

87. If the boards decide to require a net roll-forward, then an entity could indicate the expected timing of satisfaction of the net contract liability by an estimate of the amount expected to be satisfied within the next annual period. The staff notes that this is already a requirement of IAS 1, paragraph 61 and therefore does not recommend additional disclosure.