International Financial Reporting Standards

GPF meeting, Agenda paper 7

Revenue from Contracts with Customers

Global Preparers Forum

November 2011

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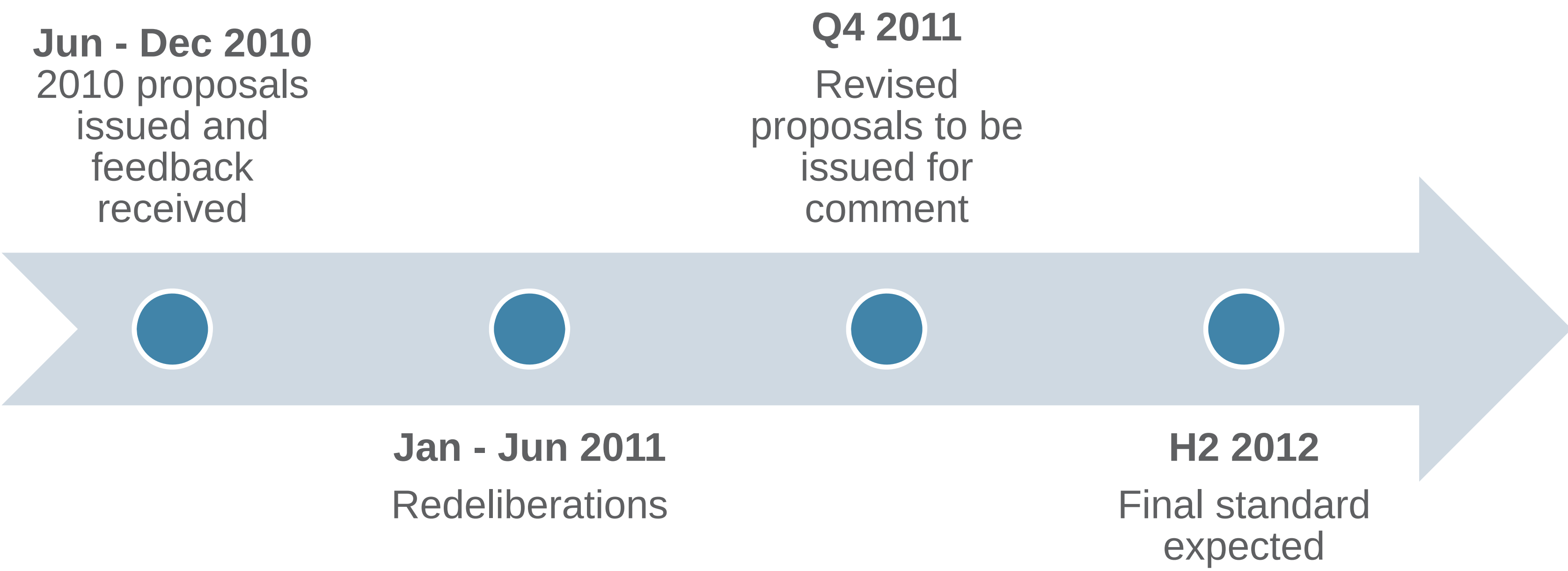
Agenda

- Project status
- A brief recap of the revised revenue proposals
  – summary of steps to apply the proposed model
  – other changes
- Objectives of re-exposure
  – what we want to know during the re-exposure process

Project status

- Although not a required due process step, the draft revenue standard will be re-exposed for public comment



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Overview of revised proposals

Core principle of the revenue proposals:

Recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity *expects to be entitled* in exchange for those goods or services

Steps to apply the core principle are the same:

1. Identify the contract(s) with the customer
2. Identify the separate performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognise revenue when a performance obligation is satisfied

Step 1: Identify the contract(s)

Objective: to identify the bundle of contractual rights and obligations to which an entity would apply the revenue model

- Specified criteria must be met to apply the model to a contract
- Some contracts would be combined and accounted for as one contract
- Contract modifications
  - some accounted for as a separate contract
  - otherwise, re-evaluate remaining performance obligations

Step 2: Identify the separate performance obligation(s)

Objective: to identify the promised goods or services that are distinct and, hence, that should be accounted for separately

- A good or service is distinct if either:
  - the entity regularly sells the good or service separately
  - the customer can benefit from the good or service on its own or together with other readily available resources
- A good or service that is part of a bundle of goods or services is not distinct if both:
  - the goods or services are highly interrelated and the entity provides a significant service to 'integrate' them into items for which the customer has contracted
  - the bundle of goods or services is significantly modified or customised to fulfil the contract

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Step 3: Determine transaction price

2010 objective: to determine amount of consideration that an entity expects to *receive* in exchange for promised goods or services

- Common responses to 2010 ED included
  - good in concept, difficult in practice
  - probability-weighted estimates not relevant for binary outcomes and costly to prepare
  - reflecting customer credit risk in initial estimate of transaction price would be costly and subsequent reassessment of credit risk might result in ‘lost’ revenue
  - adjusting the transaction price for the effects of the time value of money could be complex

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Step 3: Determine transaction price

New objective: to determine amount of consideration that an entity expects to *be entitled* in exchange for promised goods or services

- Estimate variable consideration at expected value or most likely amount
  - use the method that is a better prediction of the amount of consideration to which the entity will be entitled
- Adjust for time value of money only if there is a financing component that is significant to the contract
- Customer credit risk accounted for under other standards and presented adjacent to revenue line on income statement

Step 4: Allocate transaction price

Objective: to allocate to each separate performance obligation the amount to which the entity expects to be entitled

- Allocating on a relative standalone selling price basis will generally meet the objective
  - estimate selling prices if they are not observable
  - residual estimation techniques may be appropriate
- Contingent amounts are allocated entirely to one performance obligation if specified criteria are met

Step 5: Recognise revenue

Objective: to recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service

- A good or service is transferred when (or as) the customer obtains control of that good or service
- Responses to 2010 ED suggested:
  - clarifying the principles/indicators for determining whether control is transferred (and a performance obligation satisfied) at a point in time or over time
  - control is difficult to apply to construction and services contracts

Step 5: Recognise revenue

- A performance obligation is satisfied over time if the entity's performance either:
  - Creates or enhances an asset (eg WIP) that the customer controls as the asset is created or enhanced, or
  - Does not create an asset with alternative use and:
    - The customer benefits as the entity performs, or
    - Another entity would not need to re-perform work completed to date, or
    - The entity has a right to payment for work completed to date.
- If over time, an entity must select an appropriate measure of progress toward completion
  - Appropriate methods include output methods and input methods

Step 5: Recognise revenue

- If not over time, must consider the indicators to determine at what point the performance obligation is satisfied
  - A right to payment for the asset
  - Legal title
  - Physical possession
  - Risks and rewards of ownership
  - Customer acceptance
- It is not necessary to meet all the indicators and no single indicator is determinative
  - An entity must consider all facts and circumstances to determine when the customer obtains control of a promised good or service

Step 5: Recognise revenue

Constraint: the cumulative amount of revenue recognized is limited to the amount to which an entity is reasonably assured to be entitled

- Entity is reasonably assured only if:
  - The entity has experience with (or has other evidence about) similar types of performance obligations, and
  - The entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled
- Various factors might indicate that the entity's experience is not predictive

Overview of the cost proposals

- Costs of obtaining a contract
  - Eligible for capitalisation if they are incremental (eg selling commissions) and are expected to be recovered
- Costs of fulfilling a contract (eg precontract or setup costs) would be recognised as an asset if they:
  - Relate directly to a specific anticipated contract
  - Relate to future performance
  - Are expected to be recovered

Other proposals

2010 exposure draft	Proposal in the revised exposure draft
The onerous test should be performed at the level of each performance obligation	Onerous test limited to those satisfied over time. Costs applied are lower of direct costs and the amount paid to cancel the contract
Distinguishes two warranties, both defer revenue based on a selling price	A warranty should be accounted for as a separate performance obligation if the customer has the option to purchase separately.
Account for licences based on exclusivity	Licences transfer at a point in time, if it is distinct from other goods or services.
Transition and effective date	Retrospective application; four practical expedients proposed. On current timetable-not before 1 January 2015. Early application permitted.

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Disclosure

Objective: to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers

- Disclosure proposals include information about:
  - contracts with customers (including disaggregation of revenue and a reconciliation of contract balances)
  - significant judgements, and changes in judgements, made in applying the proposals
  - any assets recognised from the costs to obtain or fulfil a contract with a customer.
- Materiality considerations
- Implications for interim reporting

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Summary of redeliberations

- Clarified the Boards' intentions
  - amended principles (eg identifying separate performance obligations)
  - included additional guidance (eg determining when transfer of a service occurs)
- Revised some other proposals
  - many revisions resulted in simplifications (eg measurement, transition)
  - some revised proposals now align more closely with current requirements (eg warranties)

What do we want to know?

General feedback

- Main objective of the re-exposure is to confirm whether the drafting of the revised proposals
  - is clear and complete
  - can be applied in a way that reflects the economic substance of an entity's contracts with customers
  - does not produce unintended consequences

What do we want to know?

Specific feedback

- Specific comments invited on
  - Transfer of control of goods or services over time
  - Presenting impairment losses in a separate line adjacent to revenue
  - Constraining revenue to an amount that the entity is reasonably assured to be entitled
  - Scope of the onerous test
  - Disclosures in interim reports

Questions or comments?

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