Financial Accounting Standards Board

International Accounting Standards Board

Revenue from Contracts with Customers

Global Preparers Forum, Agenda paper 5

12 November 2012

Project objective

Objective: To develop a single, principle-based revenue standard for US GAAP and IFRSs

- The revenue standard aims to improve accounting for contracts with customers by:
  - Providing a more robust framework for addressing revenue issues as they arise
  - Increasing comparability across industries and capital markets
  - Requiring better disclosure

Project status

2010

2011

2013

June 2010

Exposure draft

Revenue from Contracts with Customers

974 comment letters

November 2011

Revised exposure draft

Re-exposure of *Revenue from Contracts with Customers*

358 comment letters

March 2012

Comment letter deadline

April 2012

Roundtables

May 2012 onwards

Redeliberations

H1 2013

IFRS issued

Retrospective transition proposed

Effective date to be determined

Overview of feedback

Project objective and proposals are generally supported, but…

- Requests to clarify and refine the proposals
  - Identifying separate performance obligations
  - Determining revenue over time
- Difficulties in practically applying proposals
  - Time value of money
  - Retrospective transition
- Disagreement
  - Disclosure requirements
  - Onerous performance obligations
  - Application to the telecommunications industry

Redeliberations plan

MONTH	REDELIBERATION TOPIC
Complete	• Identification of separate performance obligations (Step 2) • Satisfaction of performance obligations (Step 5) • Onerous test • Time Value of Money (Step 3) • Contracts with customers that contain nonrecourse, seller-based financing • Contract issues (Step 1) • Contract modifications • Measures of progress (Step 5)
November 2012 (these topics are being re-discussed after no decisions were reached in their first meetings)	• Licences • Constraining the cumulative amount of revenue recognised (Step 5) • Collectibility (Step 3)
Upcoming topics	• Allocation of the transaction price (Step 4) • Costs • Nonfinancial assets • Scope • Disclosures • Transition, effective date & early adoption • Sweep issues & consequential amendments • Cost-benefit analysis

Previously discussed:

July 2012
September 2012
September 2012

Overview of revenue proposals

Core principle:

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:

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)

Proposal	Tentative decisions
Specified criteria must be met to apply the model to a contract	• Additional guidance to determine whether a contract with a customer exists based on the customer's commitment to perform its obligations under the contract
Some contracts would be combined and accounted for as one contract	• Clarified the identification of performance obligations in distribution networks.

Contract modifications
• Some accounted for as a separate contract
• Otherwise, reevaluate remaining performance obligations
	• Retain the contract modifications proposals with the following improvements:
	  • contract modifications that change only the transaction price should be accounted for consistently with other modifications rather than as a change in the transaction price
	  • accounting for 'contract claims and the application of modifications within the scope of paragraph 22(a) will be clarified

Step 2: Identify the separate performance obligation(s)

Proposal	Feedback

A good or service is distinct if either:
• The entity regularly sells it separately
• The customer can benefit from the good or service on its own or together with other readily available resources
 	
However, it is not distinct if:
• It is part of a bundle of goods or services that are highly interrelated so that a significant 'integration service' is required
• That bundle is significantly modified or customised to fulfil the contract
	• Support for identifying a separate performance obligation on the basis of whether the good or service is distinct
	• 'Distinct' criteria has improved from 2010 ED, but:
	    • Two-step approach is confusing
	    • Some concepts should be clarified (eg significant integration service)
	    • Difficulties in applying the criteria to some contracts (eg software customization contracts)

As a practical expedient, two or more distinct goods or services may be treated as a single performance obligation if they have the same pattern of transfer	• Viewed as an accounting policy choice • Unclear whether repetitive services would have the same pattern of transfer • Consequential effects (eg onerous test)

Step 2… Tentative decision

- A promise to transfer a good or service (or a bundle of goods or services) is a separate performance obligation only if the promised good or service is:
  - capable of being distinct—the customer can benefit from the good or service on its own or together with other readily available resources; and
  - distinct within the context of the contract—the good or service is not highly dependent on, or highly interrelated with, other promised goods or services in the contract
- Indicators that a good or service is distinct within context of the contract

Entity does not provide a significant service of integrating the good or service into a combined item (inputs to produce an output)	The good or service does not significantly modify or customise other promised goods or services	Purchasing (or not purchasing) the good or service would not significantly affect the remainder of the contract	The good or service is not part of a series of consecutively delivered goods or services accounted for as performance obligations satisfied over time with a single measure of progress

Step 3: Determine the transaction price

Proposal	Feedback
The transaction price is the amount of consideration to which the entity expects to be entitled in exchange for promised goods or services • Includes estimates of any variable consideration • Use *expected value* or the *most likely amount* depending on which is better prediction	• General agreement on the changes made in 2011 ED
Account for time value of money only if there is a financing component that is significant to the contract	• Complex and costly to implement • Captures contracts where primary intent of payment terms is not to provide financing • Mixed views on 12-month practical expedient
Effects of customer credit risk excluded from revenue but presented adjacent to revenue line on income statement	• Most agree with excluding customer credit risk from the transaction price • Many preparers disagree with proposed impairment loss presentation

Step 3… Redeliberations update

Time value of money (tentative decisions)

- Clarify the factors in paragraph 59 that indicate whether a contract has a significant financing component
- Retain the 1 year practical expedient

Customer credit risk (further discussion required)

- Presentation of impairment loss
  - Should impairments arising from contracts with customers *with* significant financing components also be co-located adjacent to revenue?
- Should the revenue standard include a minimum collectibility recognition threshold?

Step 4: Allocate the transaction price

Proposal	Feedback
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	• Some disagreement with the proposed basis for allocating the transaction price—a common view among those in the telecommunications industry • Additional guidance requested on allocating the transaction price when more than one good or service has a selling price that is highly variable or uncertain
Discounts and contingent amounts are allocated entirely to one performance obligation if specified criteria are met	• Some requests for greater flexibility

Step 4… Issues for redeliberation

- Application of the residual approach to estimate stand-alone selling prices
  - eg mobile phone handsets sold as part of a bundled arrangement or software contracts whereby two or more of the promised goods or services have highly variable or uncertain stand-alone selling prices
- Consider the basis for allocating discounts or variable consideration

Overview of Step 5: Recognise revenue

Revenue is recognised when (or as) the entity satisfies a performance obligation by transferring a promised good or service to the customer

Performance obligations satisfied over time

A performance obligation is satisfied over time if the criteria in paragraph 35 are met (see following slide)

Revenue is recognised by measuring progress towards complete satisfaction of the performance obligation.
Tentative decisions clarified:

- Units produced or delivered may be a reasonable proxy in some cases
- Application of input methods (eg uninstalled materials)

Performance obligations satisfied at a point in time

All other performance obligations are satisfied at a point in time

Revenue is recognised at the point in time when the customer obtains control of the promised asset.
Indicators of control include:

- Present right to payment
- Legal title
- Physical possession
- Risks and rewards of ownership
- Customer acceptance

Step 5: Recognise revenue

An overview of the paragraph 35(b) criteria (2011 ED)

- A performance obligation is satisfied over time if:
  - The entity's performance does not create an asset with alternative use to the entity; and
  - At least one of the following three criteria is met:
    - The customer benefits as the entity performs, or
    - Another entity would not need to re-perform work to date (other entity would not have benefit of any WIP), or
    - The entity has a right to payment for work completed to date

Step 5: Recognise revenue

Feedback

- Support for the criteria for revenue over time
  - generally captures appropriate contracts, but some concerns about consistency with control principle
- Suggestions to clarify the criteria in paragraph 35
  - meaning of ‘alternative use’, and the relevance of contractual restrictions
  - whether ‘no need to substantially re-perform’ criterion should apply only to service contracts
  - additional guidance on determining whether an entity has a ‘right to payment for work performed to date’

Step 5… Tentative decision

- An entity satisfies a performance obligation and recognises revenue over time if one of the following criteria are met:
  a. the customer receives and consumes the benefits of the entity's performance as the entity performs
     - an objective basis for assessing benefit—hypothetically, would another entity need to substantially re-perform the work the entity has completed to date if that other entity were to fulfil the remaining obligation to the customer?
  b. the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced
  c. the entity's performance does not create an asset with an alternative use to the entity and the entity has a right to payment for performance completed to date and it expects to fulfil the contract as promised

Step 5: Constraint on the cumulative amount of revenue recognised

Proposal	Issues for redeliberation include
When consideration is variable, the cumulative amount of revenue recognised is limited to the amount to which an entity is reasonably assured to be entitled An entity is reasonably assured if: • it has experience with similar types of performance obligations • its experience 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	• Use of the term 'reasonably assured' • Clarify meaning of 'predictive experience' • Clarify principles to address royalties (paragraph 85)

Constraint… Redeliberations update

- Topics discussed at the September board meeting included:
  - the objective of the constraint—ie revenue should be constrained if the amount of transaction price allocated to a satisfied performance obligation could reduce significantly
  - three options for determining when revenue should be constrained

Option 1 **Indicator Approach** (2011 ED)	**Option 2** **Determinative Approach** (Qualitative/Quantitative)	**Option 3** **Threshold Approach** (Quantitative)
Retain the indicators in paragraph 82 of the 2011 ED for assessing whether revenue should be constrained	Revenue should be constrained when: • there are possible outcomes to the transaction that would result in a significant reversal of revenue recognised; and • those possible outcomes have a reasonable chance of happening.	In assessing whether revenue should be constrained, an entity only has predictive experience when it is “highly confident” that the amount of revenue recognised will not change Is a definition of “highly confident” needed?

Contract costs

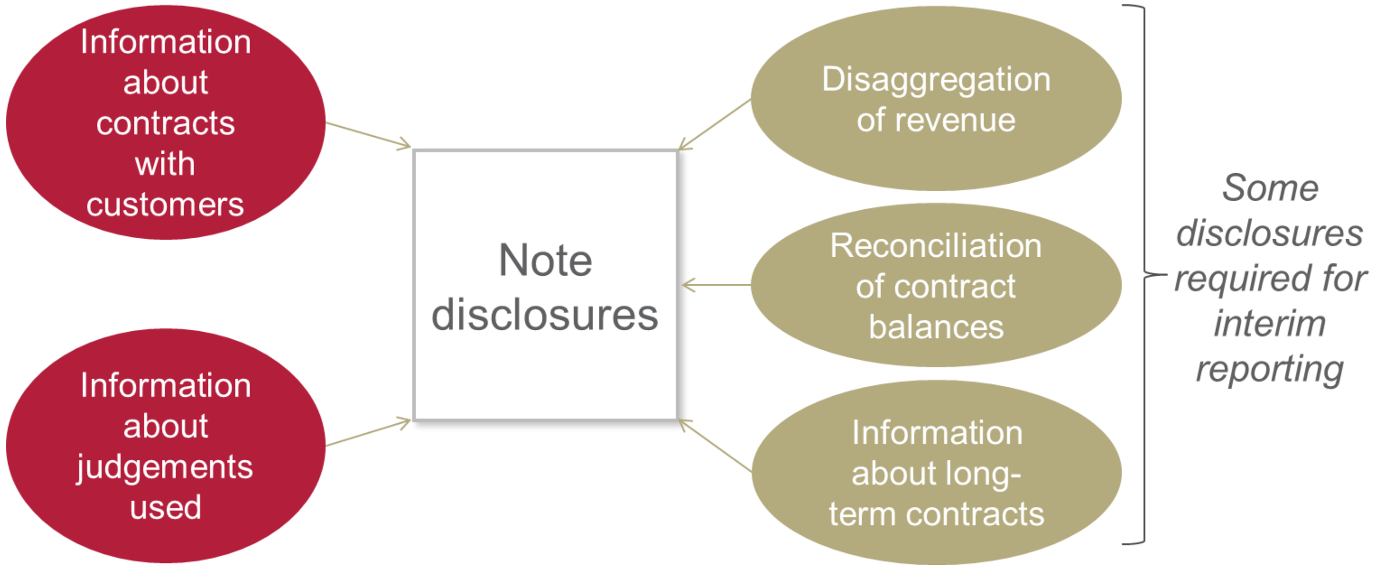
Costs of obtaining a contract	Costs of fulfilling a contract
Recognised as an asset if they are incremental and are expected to be recovered (eg sales commissions) *Feedback:* *Some agree but others prefer to expense*	Recognised as an asset if they: • Relate directly to a contract • Relate to future performance • Are expected to be recovered (eg pre-contract or setup costs)

Onerous test… Tentative decision

- The revenue standard will not include an onerous test
- Instead, an entity will apply the onerous tests in existing IFRSs or US GAAP

IFRSs	Requirements in IAS 37 for onerous contracts would apply to all contracts with customers
US GAAP	Existing guidance for recognition of losses will be retained, including guidance in Subtopic 605-35 for losses on construction and production contracts

Disclosure



- Redeliberations to consider costs and benefits of annual and interim disclosures
  - Users—level of disclosure is appropriate (or more is required)
  - Preparers and others—disclosure proposals are excessive, overly prescriptive and requires information not used by management

Application guidance: Licences

Proposal	Feedback
A promise to grant a licence to a customer is a performance obligation that an entity satisfies at a point in time But, if the licence is not distinct: • an entity would combine the licence with other promises in the contract to identify a separate performance obligation; and • the entity would recognise revenue when (or as) that performance obligation is satisfied	• Many agreed with change from 2010 ED, which had proposed accounting for licences based on exclusivity • Some disagreed with the 2011 proposals because they consider that an entity's performance is not complete once the licence has transferred to the customer. (Some of that disagreement appears to have arisen because of a misunderstanding of the effect of the proposals)

Licences… Redeliberations update

- Further discussion required after initial board meeting in July
  - Differing views on nature of the promise to transfer a license

Staff thinking:

- An entity should determine whether the licence being granted to a customer transfers resources to the customer at a point in time or over time
  - Consequently, some licences would give rise to performance obligations satisfied at a point in time and other licences would give rise to performance obligations satisfied over time
- For licences that transfer resources over time, the licence is a right to access to a portion of underlying intellectual property

Transition and effective date

Proposal	Feedback
Retrospective application with some practical expedients	• Users mostly agree • Others think costs would outweigh benefits • Strong support to allow prospective application
Effective date no earlier than annual reporting periods beginning on or after 1 January 2015 (but depends on when standard issued)	• Retrospective application requires longer time between issuance and effective date

More information

Additional information about the revised proposals and the revenue recognition project is available at www.ifrs.org and www.fasb.org.

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 presenters. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.