

STAFF PAPER

Week of 19 November 2012

FASB | IASB Meeting

FASB Education Session 14-15 November 2012

Project	Revenue Recognition		
Paper topic	Constraining the cumulative amount of revenue recognised – Cover note		
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Summary of papers for this meeting on this topic

1. The Boards' 2011 exposure draft *Revenue from Contracts with Customers* ("the 2011 ED") proposed a constraint on the cumulative amount of revenue recognised that would apply if the amount of consideration to which an entity expects to be entitled is variable ("the constraint"). The constraint was proposed in paragraphs 81 – 85 of the 2011 ED.
2. At the September 2012 joint Board meeting (refer to agenda paper 7A/162A), the staff presented feedback on the 2011 ED and discussed the application of the constraint and potential alternatives.
3. At the September 2012 meeting, the Boards tentatively decided to clarify the meaning of 'variable consideration' to indicate that the constraint should apply to a fixed price contract in which there is uncertainty about whether the entity would be entitled to that consideration after satisfying the related performance obligation. The Boards asked the staff to perform further analysis on the remaining issues related to the constraint and to bring the topic back to a future meeting.

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4. In response to that request, the staff have prepared papers that address the following issues related to the constraint:
- (a) Agenda Paper 7B/164B – this paper analyses whether any amendments should be made to the 2011 ED regarding how an entity determines *whether the constraint should apply* (with a focus on paragraphs 81 – 83 of the 2011 ED).
 - (b) Agenda Paper 7C/164C – this paper analyses whether the constraint should be included in Step 3 or Step 5 of the model (with a focus on paragraph 84 of the 2011 ED), as well as how the constraint should apply if the consideration promised by a customer includes both fixed and variable amounts.
 - (c) Agenda Paper 7F/164F – this paper primarily analyses the implementation guidance on licenses, including an analysis of what the nature of the promise is in a license and then an analysis of the application of other relevant steps in the model, including applying the constraint included in paragraph 85 of the 2011 ED.
 - (d) Agenda Paper 7G/164G – this paper provides illustrative examples of the implementation guidance on licenses, including an analysis of the views presented in agenda paper 7F/164F, but also illustrates how the other steps of the model including the constraint on revenue would apply to licences.
5. As a reminder, the revenue constraint in the 2011 ED does *not* address concerns regarding collectability. The staff have prepared a separate agenda paper 7E/164E, which considers collectability, or the customer’s credit risk – that is, the risk that an entity will be unable to collect from the customer the amount of consideration to which the entity is entitled in accordance with the contract.
6. The papers at this meeting do not address the following aspects related to the constraint:
- (a) scope and application of the constraint in paragraph 85 of the 2011 ED, which constrained the amount of revenue recognised when an entity

licenses intellectual property to a customer and the customer promises to pay an additional amount of consideration that varies on the basis of the customer's subsequent sales of a good or service (for example, a sales-based royalty). The staff plan to bring these issues back to the Boards at a future meeting after tentative decisions are reached on the general constraint and license topics outlined above;

- (b) specific disclosure requirements that might be useful to include related to the constraint. This will be addressed as part of the Boards' discussions on disclosure requirements; and
- (c) application to some types of transactions common in the asset manager industry. This issue will be incorporated into one of the broader topics that we are planning on bringing back to the Boards at a future meeting.

Appendix A

A1. The following table lists the proposed requirements from the 2011 ED that relate to the constraint and identifies which of those proposals might change as a result of the staff recommendations in the package of papers dealing with the constraint.

Proposals from the 2011 exposure draft	Anticipated change?
<p>Constraining the cumulative amount of revenue recognised (see paragraphs IE11–IE13)</p> <p>81 If the amount of consideration to which an entity expects to be entitled is variable, the cumulative amount of revenue the entity recognises to date shall not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount of consideration allocated to satisfied performance obligations only if both of the following criteria are met:</p> <p>(a) the entity has experience with similar types of performance obligations (or has other evidence such as access to the experience of other entities); and</p> <p>(b) the entity’s experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.</p>	<p>The staff recommend:</p> <p>a) clarification of the objective of the constraint (refer to paper 7B/164B), and</p> <p>b) that a decision on the location of the constraint should be made as part of the drafting process. (refer to agenda paper 7C/164C)</p>
<p>82 Indicators that an entity’s experience (or other evidence) is not predictive of the amount of consideration to which the entity will be entitled include, but are not limited to, the following:</p> <p>(a) the amount of consideration is highly susceptible to factors outside the entity’s influence. Those factors include volatility in a market, the judgement of third parties, weather conditions and a high risk of obsolescence of the promised good or service.</p> <p>(b) the uncertainty about the amount of consideration is not expected to be resolved for a long period of time.</p> <p>(c) the entity’s experience (or other evidence) with similar types of performance obligations is limited.</p> <p>(d) the contract has a large number and broad range of possible consideration amounts.</p>	<p>No material change expected. (refer to agenda paper 7B/164B)</p>
<p>83 An entity shall use judgement and consider all facts and circumstances when evaluating whether the entity’s experience is predictive of the amount of consideration to which it will be entitled. The presence of any one of the indicators in paragraph 82 does not necessarily mean that the entity is not reasonably assured to be entitled to an amount of consideration.</p>	<p>No material change expected. The staff recommend that this paragraph be incorporated into the objective for the constraint. ie the revised paragraph 81. (refer to agenda paper 7B/164B)</p>
<p>84 If an entity is not reasonably assured to be entitled to the amount of the transaction price allocated to satisfied performance obligations, the</p>	<p>No material change expected.</p>

cumulative amount of revenue recognised as of the reporting date is limited to the amount of the transaction price to which the entity is reasonably assured to be entitled.	(refer to agenda paper 7C/164C)
85 Notwithstanding the requirements in paragraphs 81–83, if an entity licences intellectual property (see paragraph B33) to a customer and the customer promises to pay an additional amount of consideration that varies on the basis of the customer’s subsequent sales of a good or service (for example, a sales-based royalty), the entity is not reasonably assured to be entitled to the additional amount of consideration until the uncertainty is resolved (ie when the customer’s subsequent sales occur).	To be discussed in a future meeting.