AGENDA PAPER

IFRS Foundation Trustees meeting—Due Process Oversight Committee

South Africa	**July 2013**	**Agenda ref 3D**
To:	Scott Evans, Chairman—Due Process Oversight Committee	
From:	Sue Lloyd	
Topic	Revenue Recognition: due process 'life cycle' review	

Overview

1. This report summarises the due process steps completed for the IASB's revenue recognition project. The project will result in a new IFRS that will replace IAS 18 *Revenue* and IAS 11 *Construction Contracts* and bring much needed clarity and additional guidance to revenue recognition under IFRS.
2. Further details of those due process steps can be found in the Due Process Paper presented to the IASB in May 2013 (attached as Agenda Paper 3D(i)). Appendix A to this report summarises discussions with the Trustees and the DPOC on this project.

Extensive due process

3. As illustrated in the IASB Due Process Paper, the IASB and the FASB (the boards) have issued three joint consultative documents on the revenue recognition project: a discussion paper (2008), an exposure draft (2010) and a revised exposure draft (2011). The fundamental principles of the revenue model have remained substantially the same since the 2010 Exposure Draft and have been broadly supported, although there remain some stakeholders (mainly European) who still question the need for a new IFRS on revenue recognition. The recent redeliberations of the 2011 Exposure Draft have focused mostly on clarifications and refinements of the principles of the revenue model (although they have resulted in quite extensive redrafting of the proposals in the 2011 Exposure Draft).
4. In their decision to issue the revised exposure draft in 2011, the boards acknowledged that while there was no formal due process requirement to publish another exposure draft, they thought it appropriate to do so because of the importance of revenue and the need to take all possible steps to avoid unintended consequences. The importance of the revenue number and the gravity of changing the related guidance has continued to be apparent in the intensive redeliberations of the 2011

Exposure Draft, which have taken into account both the feedback on the six topics on which the boards asked questions in that exposure draft, as well as feedback on other proposals that were not included in those six topics.

5. In addition to publishing three due process documents, staff and board members have carried out significant amounts of outreach, including fieldwork with preparers, to test the application of the revenue model to specific contracts. Staff and board members have also conducted outreach with users of financial statements to understand the information that is useful to them, and also to provide information on the effects of the revenue model on specific industries and transactions. A summary of the outreach activities on the 2011 revised exposure draft was presented to the IASB in May 2012 and is attached as Agenda Paper 3D (ii).
6. At the May 2013 board meeting, the IASB concluded that its revisions to the 2011 Exposure Draft do not represent fundamental changes on which additional comment is needed. Therefore, they decided that it was not necessary to re-expose the requirements. Mindful of its recent experience on hedge accounting, the Board also decided not to issue a public review draft, not least because such a draft would in effect become a fourth round of consultation on the project. The Board are aware that some stakeholders disagree with this decision. Nonetheless, as a result of the changes made to the 2011 Exposure Draft, the boards are subjecting a draft of the standard to more extensive external review than usually undertaken, covering a mix of reviewers and geographies.

Activities on particular topics

7. As the project progressed, the IASB became aware of particular industries that would be more significantly affected by the revenue model and of topics for which a significant number of stakeholders had strong, and sometimes conflicting, views. The staff and the IASB conducted additional outreach with representatives of those industries and publicly discussed the topics. The following is a summary of those industries and topics:
   (a) **Telecommunications industry—**Most respondents from the telecommunications industry disagree with the accounting required by the revenue model because it would require them to separate their contracts into two performance obligations (or promises)—a handset and an airtime service contract—and to recognise revenue as each is satisfied (ie when the handset is transferred to the customer and as services are rendered). This would typically require them to attribute to the handset (which is often provided ‘free’ or at a significant discount) some of the contractual consideration that is due as airtime services are rendered. Respondents from that industry disagreed with this outcome, largely because they do not view the transfer of a handset as a

revenue generating activity but rather as a cost of obtaining a customer for the purposes of providing airtime services. Outreach with users of financial statements in the telecommunications industry also did not indicate that they would find the accounting useful. In addition, those respondents explained that implementing the revenue model would be costly and complex because each entity has a high volume of contracts with various potential configurations.

Action: The staff and the boards held several meetings in 2010-2013 with representatives from the telecommunications industry, their auditors and users (both together and separately). The focus of the meetings was to understand industry issues including the complexity of implementation of the revenue standard and user views on useful information. Representatives from the industry presented their issues to the boards in a joint public meeting in May 2011 and to a small group of board members in a private forum in April 2012. The boards specifically considered detailed analyses of the industry concerns at two separate public meetings (June 2011 and December 2012). The telecommunications industry has therefore been given specific consideration by the boards during its deliberations and has been given greater consideration than any other industry.

The boards decided not to make any amendments specifically for this industry. They concluded that the accounting under the model is a better reflection of the economics of the underlying transaction because it attributes revenue to both the handset and the airtime services in a way that reflects the respective value of those two components. The boards also noted that any amendment to the model to address the concerns raised would, however crafted, inevitably be perceived as an industry exception and would create the risk of other industries also seeking exemption from parts of the model. This could therefore undermine one of the key objectives of the revenue standard, which is to enhance the comparability of accounting for revenue across different industries. The boards observed that the industry could apply the model in a more cost effective manner by using an approach that aggregates similar contracts into portfolios, and will note this in the Basis for Conclusions to ensure that the boards' intended use of a portfolio approach is properly understood.

Subsequent to the December 2012 meeting, a large group of telecommunication companies wrote to the IASB Chairman[1]. Whilst noting their disappointment at the boards' decision, they nonetheless recorded that they were 'grateful to the Staff and Board members for their time spent with us and with users of our financial statements over recent years to understand the impact of the ED on our industry'.

(b) **Construction industry**—The boards received a significant number of comment letters from respondents in the construction industry in response to the 2010 Exposure Draft. Although many of these were 'form' letters from non-public entities in the US, respondents in the construction industry explained that they were concerned that the revenue model proposed in the 2010 Exposure Draft would fundamentally change the way in which revenue is recognised in their industry. That is because they thought the revenue model would require them to recognise revenue only when construction is complete, which would have been in contrast to the current practice of recognising revenue as construction progresses (ie on a 'percentage-of-completion' basis). Many also thought that the revenue model would require entities to segment a construction contract into numerous parts, even though what they have typically promised is a single output (eg a house) and the service of integrating many inputs into that single deliverable.

Action: The staff and the boards conducted significant outreach in the construction industry after the publication of the 2010 Exposure Draft, including industry specific webcasts and meetings. As a result, in the 2011 Exposure Draft the boards proposed additional requirements for determining when revenue can be recognised over time (ie as construction progresses similar to today's percentage-of-completion basis) and refined the requirements for segmenting a contract (ie identifying the separate performance obligations) to better express the boards' intentions. As a result of these changes, the construction industry expressed significantly less concern about the 2011 Exposure Draft. Their remaining concerns related mainly to points of clarification that the boards are addressing in the drafting of the final requirements.

(c) **Residential real estate (ie contracts currently accounted for in accordance with IFRIC 15 *Agreements for the Construction of Real Estate*)**—Many respondents and the IFRS Interpretations Committee requested that the IASB provide clarity in the revenue recognition project regarding the appropriate revenue recognition pattern for the construction of residential real estate (ie the construction of high-rise apartments or condominiums). This request stemmed

[1] The letter is available at http://www.ifrs.org/Current-Projects/IASB-Projects/Revenue-Recognition/Documents/Letter-15-February-2013.pdf.

from uncertainty in current practice regarding whether the sale of real estate (specifically units in a multiple-unit development) can result in a continuous transfer to the customer (ie revenue recognised over time as construction progresses), or whether those units represent a transfer at a single point in time (with revenue recognised at a point in time, typically upon completion). This uncertainty arose from a paragraph in IFRIC 15 that appears to permit the continuous transfer, but provides limited guidance on when that continuous transfer would occur.

Action: The staff and the boards specifically considered these fact patterns in the development of the additional requirements in the 2011 Exposure Draft for determining when revenue can be recognised over time. In particular, the boards included a criterion that is expected to provide an objective basis for assessing when control of such units transfer to a customer over time. The staff and the IASB also held outreach meetings in Hong Kong, Singapore, Kuala Lumpur and Brazil regarding this issue to better understand the nature of the transactions and how the proposed requirements would apply to those transactions.

The boards observe that there will be some entities (and users of their financial statements) who will likely continue to think that they should be permitted to recognise revenue as they construct these residential units if they have a contract with a customer, but will not be eligible to do so under the requirements. In some respects this feedback is inevitable because the boards are trying to improve the comparability of the accounting for these transactions and current practice, even when the transactions are economically similar, is diverse and, often, still reflects historic accounting practices. Nonetheless, the boards believe that the final requirements, whilst still requiring judgement, will provide much needed clarity compared with IFRIC 15.

(d) **Disclosure requirements**—One of the boards' objectives in the revenue recognition project is to improve the disclosure requirements in such an important area of financial reporting. Feedback on the disclosure requirements proposed in the 2010 Exposure Draft and the 2011 Exposure Draft was polarized—preparers were concerned that the disclosure requirements were burdensome and users of financial statements thought the requirements were appropriate and, in some cases, could be improved.

Action: In addition to regular outreach and discussions, the staff and the boards held workshops in the US, Japan and London with users and preparers to discuss issues related to disclosure and transition between September and December 2012. The feedback from these workshops was considered by the boards in February 2012. In most cases, the feedback resulted in refinements of the requirements to both improve the usefulness of the information to users and to limit the costs of preparation. In particular, the boards have reduced the number of reconciliations that are required to be disclosed and the IASB has also decided not to amend IAS 34 *Interim Financial Reporting* with respect to specifying revenue disclosures in the interim financial statements, except for requiring disaggregated revenue information.

(e) **Examples and implementation guidance**—The boards received a number of requests to increase the amount and complexity of the illustrative examples and implementation guidance in the 2011 Exposure Draft. Some of the requests resulted from the level of guidance provided under US GAAP that will be eliminated upon the publication of the final standard.

Action: The boards will likely increase the number of illustrative examples that will be included in the final standard; however, the amount of implementation guidance will remain substantially the same as that included in the 2011 Exposure Draft. Additional examples have been included to illustrate the application of particular concepts or principles that respondents indicated would be helpful in the implementation of the revenue model.

Implementation group

8. As previously discussed with the DPOC on the conference call meeting held on 20 June, the boards intend to establish a group of revenue specialists that will assist in the initial application of the new revenue standard. This group is intended to provide support to preparers in their initial application of the standard and will assist in achieving consistent application.

Appendix A

REVENUE RECOGNITION DUE PROCESS LIFE CYCLE REVIEW: REPORTING TO THE TRUSTEES AND THE DUE PROCESS OVERSIGHT COMMITTEE (DPOC)

Date	Trustees/DPOC	Report
Mar 2008	Trustees	*(Draft) Report of the IASB Chairman* (Agenda Paper, AP4) noted that a Discussion Paper (DP) was due mid-2008 illustrating what an asset and liability model would entail for Revenue Recognition, and comparing the effects of two measurement approaches. It was noted that responses to the DP would help develop a single common standard.
Jul 2008	Trustees	Reference in the *IASB Chairman's Report to the Trustees* (AP 4A) *that* Revenue Recognition formed part of the 2011 work plan and that a DP would probably to be published later in 2008.
Oct 2008	Trustees	Reference in paper on *The IASB'S work plan – October 2008* (AP 5B), noting that the IASB and the US FASB continued to develop a model for revenue recognition. It referred to the Boards' view as favouring measuring obligations in the contract by reference to the transaction price in the contract (the customer consideration amount). Work continued towards publishing a DP at the end of 2008.
Jan 2009	Trustees	Reference in the *IASB Work Plan Overview* (AP 5A) that the Boards planned to issue in mid-December 2008 a joint DP with a 180 day comment period. The DP contained proposals on when and how entities should recognise revenue arising from contracts with customers to provide goods and services. The AP noted that the proposals should simplify existing requirements in US GAAP.
Apr 2009	DPOC	Reference in paper *Completing the February 2006 Memorandum of Understanding: A progress report and timetable for completion September 2008 (*AP2A) noting that joint deliberations were still on going. Estimated completion date for a standard was 2011.
Apr 2009	Trustees with Monitoring Board (MB)	Reference in *Draft report of the IASB Chairman – 2008 Annual Report* (AP MB 2D) to a joint DP published in December 2008. The *Minutes* noted concerns regarding elements of the 2011 timetable with the FASB and achieving converged solutions, including on Revenue Recognition.
Jul 2009	Trustees	Reference in *Chairman's Report* (AP 5A), noting that the deadline for comments on the DP was 19 June 2009.
Oct 2009	Trustees	Reference in *Chairman's report* (AP 4B (i)) noting that 221 comment letters had been received in response to the DP. The AP noted that the project was particularly important to the successful completion of the MOU as many commentators believed there was not sufficient application guidance in the current IFRS requirements.
Jan 2010	Trustees	Reference in *Report of the IASB Chairman* (AP 4A) noting that several workshops had been conducted in December 2009 with preparers from a variety of industries: feedback to proposals was encouraging. The AP noted that an Exposure Draft (ED) was being targeted for issue in March.
Mar 2010	Trustees	Reference in *IASB and FASB Commitment to Memorandum of Understanding: Quarterly Progress Report, March 31, 2010* (AP 2B) The IASB and FASB were currently considering feedback from DP and outreach programmes. Milestone targets updated, anticipating an ED in Q2 2010 and final standards in Q2 2011.
Mar 2010	Trustees with MB	Reference in *The Technical Agenda (draft for annual review)* (AP 2C (i)) - reiteration of comments noted above.
Jul 2010	Trustees	Reference in *Progress Report on Commitment to Convergence of Accounting*

Date	Trustees/DPOC	Report
		Standards and a Single Set of High Quality Global Accounting Standards: 24 June 2010 (AP 5). Milestone targets set for ED Q2 2010, public round-table meetings Q4 2010 & standards Q2 2011.
Oct 2010	Trustees	Reference in *Report of the IASB Chairman* (AP 7A) noting ED published 24 June, with comments due 22 October. Round table meetings were planned for November. Field visits had been undertaken to ensure proposals implementable. Planned completion June 2011.
Oct 2010	DPOC	Reference in *Joint meeting with the IASB and the Due Process Oversight Committee, 13 September 2010* (AP 8A), noting that revenue recognition was one of three critical topics that remained outstanding.
Feb 2011	Trustees	Reference in *Chairman's Quarterly Review* (AP 8A) noting that the ED had generated 971 comment letters (including 247 letters from entities in construction industry). Round tables had been held in UK, US and Malaysia. Two main issues to consider: (a) separating a contract and (b) determining when goods and services were transferred to a customer. The AP noted that the Boards acknowledged the need to explain more clearly the principles behind these fundamental parts of the model, and to ensure the standard could be applied consistently across wide range of contracts.
Mar 2011	DPOC	Reference in *Update on Enhanced Engagement* (AP 6C (i)). The IASB had considered most of the significant issues. Noted that the IFRS would explain fundamental principles more clearly to ensure consistent application of the standard across a wide range of contracts. Sectors most affected by proposals were construction, pharmaceuticals and telecoms: additional field work would be undertaken in those sectors.
Mar 2011	Trustees with MB	Reference in *IASB Chairman's Report* (AP 7). Reiteration of comments in DPOC AP March 2011 and explanation of why the project was critical to US and the IASB. Noted that US GAAP had a wide range of detailed industry-specific requirements that were widely acknowledged as being inconsistent. IASB had only general requirements that caused preparers to rely on US GAAP. Project aimed to reduce the FASB's detailed guidance to consistent principles and to remove the need for IFRS users to refer to US GAAP.
Apr 2011	DPOC	Reference in *15 April Conference Call* (AP 2) noting that full due process to be undertaken before standard issued and a June completion was unlikely. Many stakeholders had requested additional time before project completion. The *Minutes* noted that the Revenue Recognition draft paper would be ready end of May/beginning of June. It was unlikely that Revenue Recognition would need re-exposing. Working with SEC and FASB crucial to timely completion. DPOC undertook to support endeavours to complete in 2011.
Jun 2011	DPOC	Reference in *General Update* (AP2). Working draft in development for additional review. Re-exposure to be considered. The *Minutes* noted that If re-exposure was unnecessary a draft new standard would be developed, and subject to detailed drafting review as part of fatal flaw process review. In response to a query about input from investors, it was noted that the project team had spoken to analysts widely.
Jul 2011	DPOC	References in *IASB Work Plan* (AP 2A (ii)) *and General Update* (AP 2F) noting decision to re-expose proposals. Risks were regarded as being reduced due to re-exposure. The Boards intended to re-expose the work in Q3 2011 for comment period of 120 days. FASB to undertake fatal flaw review. ED to seek comment on four basic issues. Board members and staff to develop outreach plan to address sensitive areas.
Jul 2011	Trustees	Reference in *Report by David Tweedie, Immediate IASB Past Chairman: Quarterly Review* (AP 8). General summary of due process from 2008 onwards and current position: re-exposure Q3 2011. The AP noted that

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		while there was no formal due process requirement to re-expose the Boards had decided to take this extra step given the importance of the revenue number to all companies and the need to take all possible steps to avoid unintended consequences. The *Report of the IFRS Advisory Council Chairman (AP 10)* noted the welcome for re-exposure from AC members and referred to the Boards' decision to make no changes resulting from discussions with telecom companies
Jul 2011	Trustees with MB	Reference in *Due Process Oversight Activities* (AP MB 2). Paper noted DPOC's belief that due process steps taken on the project were appropriate and reflected the necessary commitment to quality and full due process.
Oct 2011	Trustees	Reference in *Report of the IASB Chair* (AP 2). An update on activities related to the project to date and decision to re-expose. Revised ED expected to be published November 2011 with a comment letter period of 120 days, therefore comment deadline expected to be March 2012. Discussion would be limited to five questions. Usual publicity to follow as well as outreach activities. Public discussions planned in UK, US and Japan. References in *The Technical Agenda (AP 2 - appendix B)* reiterated information in Chair's report
Oct 2011	DPOC	Reference in *Due Process Update* (AP 3F). Section of paper summarised the progress to date and the outreach activities planned, including that targeted specifically towards investors.
Jan 2012	Trustees	Reference in *Report of the IASB Chair* (AP 2) giving a summary of activities to date. Outreach projects to be tailored to real estate developers in Asia and Brazil to ensure the proposed standard addresses local issues raised in relation to IFRIC 15 Agreements for the Construction of Real Estate. Updates to be posted on project outreach page to ensure transparency. Also a reference in *The Technical Agenda* (AP 2 – appendix B) – an update on activities to date and revised ED timeframe.
Jan 2012	DPOC	Reference in *Due Process Update* (AP 3C). *R*evised ED published November 2011. Public discussion in UK, US and Japan planned for May 2012. Request to extend comment period received from EFRAG in December 2012. Reply from IASB explained 120 days sufficient. Correspondence attached as *Correspondence with EFRAG regarding comment period on the Exposure Draft Revenue from Contracts* (AP 3C – appendix 4).
Apr 2012	Trustees	References in *Report of the IASB Chair* (AP 2) and *The Technical Agenda* (AP 2 – appendix B) summarising activity to date and proposed outreach. Noted that comment period ended mid-March and the Boards expected to complete re-deliberations in 2012. The *Minutes* noted the comment of the IASB Chairman that Revenue Recognition had the potential to be a fully converged project.
Apr 2012	DPOC	References as above in *Due Process Update* (AP 3G).
Jul 2012	Trustees	References in *Report by the IASB Chair* (AP 2) and *The Technical Agenda* (AP 2B). Progress highlighted, notably summary of outreach activities presented to IASB at May 2012 meeting. Re-deliberations expected to be completed in 2012 with a final standard expected to be issued in early 2013. The *Summary of Conclusions* noted the belief of the IASB Chair that IASB and FASB would end up in converged position. Comments that high standards of due process had been followed. Reiteration that final standard expected early 2013
Jul 2012	DPOC	Reference in *Update on Technical activities* (AP 4D). Update on re-exposure activity, confirmation that re-deliberations expected to be completed with final standard in early 2013.
Oct 2012	Trustees	Reference in *Report of the IASB Chair* (AP 2) noting aim to complete substantive deliberations by late 2012 with final standard anticipated mid-2013. Restriction of questions asked in revised ED had proved challenging.

Date	Trustees/DPOC	Report
Oct 2012	DPOC	References in *Update on Technical Activities* (AP 3B) and *IASB Work Plan* (AP 3B (i)). Update on targeted outreach and noted that final standard anticipated mid-2013 subject to completion of due process steps. Noted greatest concerns raised by telecoms companies and real estate construction entities with the latter being jurisdiction specific. There was a risk of differences arising with the FASB due particularly to pressure to keep some guidance relevant to particular industries.
Jan 2013	Trustees	Reference in *Technical Activities – Update* (AP 2) noting that IASB and FASB had completed their substantive re-deliberations of the recognition and measurement principles in the 2011 ED. The *Summary of Conclusions* noted that the Boards would shortly re-deliberate scope, disclosure and transition and aimed still to issue final standard mid-2013
Jan 2013	DPOC	Reference in *Update on Technical Activities* (AP 3C (i)) and *IASB Work Plan* (AP 3B (i)) giving a summary of historic and current activity. The *Report of the DPOC meeting* stated that the DPOC noted that the two Boards had tentatively decided not to create an exception to the general revenue recognition model to reflect practice in the telecommunications industry, having received an extensive analysis of the application of the model to typical mobile phone contracts. The DPOC emphasised the importance of documenting the extensive outreach and analysis that had been undertaken to evidence the rationale for the Boards' decision.
Apr 2013	Trustees	References in *Report of the IASB Chair* (AP 2) and *Technical Projects – Update* (AP 2A) noting that re-deliberations were complete and that the aim was to issue a final standard in mid–2013.
Apr 2013	DPOC	Reference in *Technical Projects – Update* (AP 3A) as above. The *Report of the DPOC meeting* stated that the DPOC noted that the Boards had come under come under some pressure to issue on the website a review draft of the proposed final standard, but were not planning to do so, having issued two EDs on the project and undertaken extensive outreach. The two Boards were going through an extended fatal flaw process to ensure that the drafting of the proposed standard was clear and reflected the technical decisions reached.
May 2013	DPOC (via e-mail)	Committee sent a copy of IASB May 2013 *Revenue Recognition – Due process summary* (AP 7C) summarising due process steps on the project, assessing whether further re-exposure was necessary and seeking permission to beginning balloting on a standard.