

Revenue from contracts with customers

IASC Foundation

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Agenda

- Why we're doing the project
- Improvements to financial reporting
- Overview of proposed standard
- Main steps to apply proposed standard
- Onerous performance obligations
- Contract costs
- Disclosure
- Transition
- Who will be affected
- Feedback received on the discussion paper
- Project timeline



Why we're doing the project

- IFRSs and US GAAP are different. Both need improvement:
 - US broad recognition concepts; numerous requirements by industry
 - IFRSs have two alternative standards; can be difficult to apply
- Objective - a single, principles-based revenue recognition standard for use across various industries and capital markets
 - replace IASs 18 & 11 and most of Topic 605 in FASB Accounting Standards Codification

Improvements to financial reporting

- Single model based on clear principles
- Will improve accounting for contracts with customers by:
 - providing a more robust framework for addressing issues as they arise
 - increasing comparability across industries and capital markets
 - providing enhanced disclosures
 - clarifying accounting for contract costs



Recognise revenue to depict the *transfer* of goods or services at an amount that reflects the amount of consideration received or expected to be received in exchange for those goods or services

- Revenue recognised when a good or service is transferred to a customer satisfying a performance obligation in the contract
- Amount of revenue is the amount of the transaction price allocated to the satisfied performance obligation

Main steps to apply proposed standard

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Step 1: Identify the contract(s) with a customer

Step 2: Identify the separate performance obligations in the contract

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the separate performance obligations

Step 5: Recognise revenue when each performance obligation is satisfied



1 Identify the contract

- Most cases apply standard to a single contract
- Combine two or more contracts if prices are interdependent
- Segment a single contract into two or more contracts if some goods or services priced independently of other goods and services
- Account for a modification to a contract as a part of the original contract if price is interdependent with original contract. Otherwise accounted for as a separate contract.

2 Identify performance obligations

A performance obligation is an enforceable promise in a contract with a customer to transfer a good or service to that customer

- Account for performance obligations separately if promised good or service is distinct
 - a good or service is distinct if an identical or similar good or service is sold separately
 - if not sold separately, goods and services are distinct if function and margin are distinct

2 Identify performance obligations

Specific implementation guidance

- principal versus agent considerations
- options to acquire additional goods and services (eg discount vouchers, customer loyalty points)
- rights of return
- licenses and rights to use
- product warranties and product liabilities

- Customer obtains control of the entire licensed IP (eg exclusive license for economic life)
 - sale of the IP, not a license
- Exclusive license, but customer does not obtain control of entire licensed IP
 - performance obligation to permit customer to use IP
 - revenue over time
- Non-exclusive license
 - performance obligation to transfer licenses
 - revenue when the customer is first able to use the license

- Cover for latent defects ('quality assurance' warranty)
 - not a performance obligation
 - requires evaluation of whether the performance obligation to transfer product is satisfied
 - revenue not recognised until the defective product or component is replaced
- Cover for faults post-delivery ('insurance' warranty)
 - is a performance obligation
 - revenue is recognised over the warranty period

3 Determine the transaction price

The transaction price is the amount of consideration the company expects to receive from the customer

- Uncertain consideration included in transaction price if:
 - experience of identical or similar contracts
 - expects circumstances will not change significantly
- Adjust consideration for collectibility
- Adjust consideration for the time value of money
- Measure non-cash at fair value

4 Allocate the transaction price

- Allocate transaction price to all separately identified performance obligations in proportion to standalone selling prices
- The standalone selling price of a good or service is the price at which the entity would sell that good or service if it was sold separately at contract inception
- Standalone selling prices estimated if not observable



5 Recognise revenue when each performance obligation is satisfied

- Revenue is recognised when a performance obligation is satisfied by transferring a good or service to the customer
- Good or service transferred when customer obtains control of it

Control has transferred when the customer has the ability to direct the use of and receive the benefit from that good or service

- Transfer of control can be at a point in time or can be continuous

Onerous performance obligations

- Performance obligation onerous if direct costs to satisfy more than allocated transaction price
- Recognise a separate liability and corresponding contract loss
- Direct costs are all costs that relate directly to the contract or incurred only because of contract

- Costs may give rise to an asset recognised in accordance with other standards eg inventory
- Recognise contract fulfilment costs as asset if:
 - generate or enhance a resource used to satisfy performance obligations in the contract
 - relate directly to a contract (or anticipated contract) and
 - expected to recover under the contract
- Expense costs of obtaining a contract

Enhanced disclosures to help users understand the amount, timing and uncertainty of revenue and cash flows

- Information about contracts with customers
 - disaggregation of revenue
 - nature of performance obligations & additional information about onerous performance obligations
 - maturity analysis of remaining performance obligations in contracts with original duration of more than a year
 - reconciliation from opening to closing total contract balances
- Information about judgments and changes in judgments
 - timing of revenue recognition
 - determining and allocating the transaction price

- Full retrospective application
- Early adoption – tentative decisions:
 - permitted for first time adopters of IFRSs
 - not yet decided whether to permit for existing IFRS preparers
 - prohibited for US GAAP preparers
- Boards will consult publicly on transition and effective date for range of projects

Who will be affected *recognition*

- Revenue attributed to every distinct good or service, based on standalone selling price
 - telecommunications – ‘free’ handset will have attributable revenue
 - manufacturers – defer revenue for warranties
- Revenue recognised as good or service transfers to customer
 - construction contracts – percentage of completion
 - long-term contracts – greater unbundling
- Selling prices should be estimated, if not observable
 - software - removal of specific US guidance

Who will be affected *measurement*

- Probability-weighted estimate of contingent consideration included in the amount allocated if it can be reasonably estimated (ie if entity has relevant experience)
- Collectibility affects *how much* revenue is recognised when a good or service is transferred, not whether revenue is recognised
- Implicit financing effects (eg payment due significantly before or after transfer of goods or services) reported separately

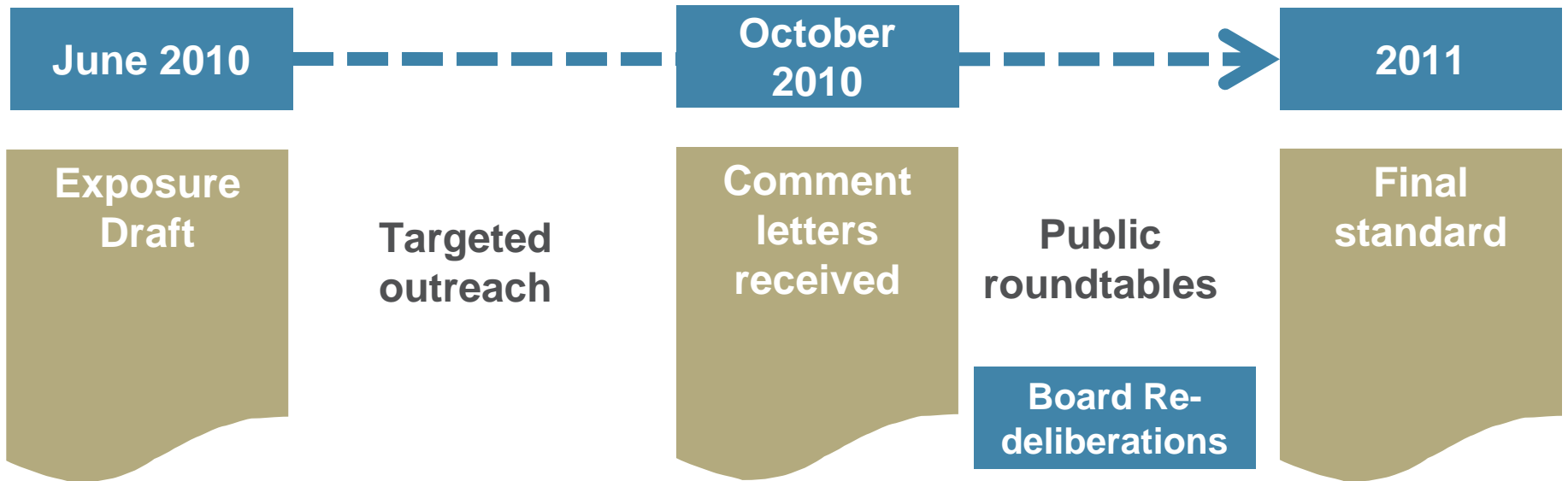
Feedback

- Clear definition & guidance required for control
- More guidance to identify separate performance obligations
- Address contract costs
- Product warranties – not all are performance obligations
- Guidance for intellectual property

Boards' response

- Definition and indicators proposed
- Clarified not requiring completed contract method for all construction contracts
- Criteria proposed ('distinct')
- Guidance proposed
- Distinguish between product warranties that are a performance obligation & a failed sale
- Guidance proposed on licenses

Project timeline



Roundtables

London, US, Tokyo



Comment by October 2010

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