IASB/FASB Discussion Paper

Preliminary Views on Revenue Recognition in Contracts with Customers

Dr. Mareike Kühne

DRSC e.V.

Öffentliche Diskussion

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BACKGROUND

IASB/FASB Project *Revenue Recognition*

- IASB/FASB address the issue of revenue recognition **startiing from the Framework definition of income.**

- That is: **"Income is measurable changes in assets and liabilities"**
  (= Assets and Liabilities Approach).

- Original idea: this approach shall **not be overridden by notions of realisation and completion of the earnings process**.

Revenue (proposed approach):

Revenue shall reflect measurable changes in net assets under contracts with customers

= Contractual Asset ./. Contractual Liability

= Expected consideration ./. Performance obligation

Resulting questions:

- Does signing of a contract lead to (measurable) changes in net assets?
- Recognition of selling revenue?
- Measurement of performance obligations?

Revenue = Expected Consideration ./. Performance Obligation

Measurement of performance obligation: **legal layoff amount**

Remeasurement: yes

Recognition:

IASB (2005)

- Selling revenue at contract inception
- Changes of value (re-measurement)
- At extinguishment of performance obligation

Information:

- Profitability of separate parts of a contract
- Efficiency of entity in comparison with market

Revenue = Expected Consideration ./. Performance Obligation

Measurement of performance obligation: **customer consideration amount**

Remeasurement: no

Recognition:

IASB (proposed)

- No selling revenue at contract inception
- No changes of value (re-measurement)
- At extinguishment of performance obligations

Information:

- Profitability of contract

THE DISCUSSION PAPER

Scope

Scope

- Proposed model would apply to contracts with customers

Contract

- Agreement between two or more parties that creates enforceable obligations
- Does not need to be in writing

Customer

- Party that has contracted with an entity to obtain an asset (such as a good or a service) that represents an output of the entity’s ordinary activities

Possible scope exclusions

No particular type of contract excluded, yet, but **exclusion discussed for**:

- **Financial instruments** and some non-financial instrument contracts that otherwise would be in the scope of standards such as IAS 39 *Financial Instruments: Recognition and Measurement* and SFAS 133 *Accounting for Derivative Instruments and Hedging Activities.*
- **Insurance contracts** that are in the scope of IFRS 4 *Insurance Contracts* and SFAS 60 *Accounting and Reporting by Insurance Enterprises* (and other related US GAAP).
- **Leasing contracts** that are in the scope of IAS 17 *Leases* and SFAS 13 *Accounting for Leases* (and other related US GAAP).

Topics not covered in the discussion paper

- Scope of a general revenue recognition standard
- Contracts with customers
- Measurement of rights
- Identification of performance obligations
- Satisfaction of performance obligations
- Measurement of performance obligations
- Alternative measurement approach
- Onerous contracts
- Presentation

Topics not covered in the discussion paper

- Disclosures
- Transition and effective date
- Consequential amendments to other standards

Future deliberations regarding scope

- **Implications** of the proposed model **for entities that recognise revenue or gains in the absence of a contract** (as is the case for entities which recognise revenue or gains from increases in inventory before obtaining a contract with a customer (in accordance with IAS 41 *Agriculture* and AICPA SOP 85-3 *Accounting by Agricultural Producers and Agricultural Cooperatives*).

- The boards plan to consider whether any **contracts** with customers should be **excluded** from the proposed model **after reviewing comments** on this discussion Paper.

Recognition

Contract based revenue recognition principle

- **Revenue** should be recognised on the basis of **increases in an entity's net position** in a contract with a customer.
- When an entity becomes a party to a contract with a customer, the **combination of the rights and the obligations** in that contract gives rise to a **net contract position**.
- Whether that net **contract position** is a contract asset, a contract liability or a net nil position **depends on** the **measurement of the remaining rights and obligations** in the contract.
- In the proposed model, **revenue** is **recognised** when a **contract asset increases** or a **contract liability decreases** (or some combination of the two).
- That occurs when an entity **performs by satisfying an obligation** in the contract.

Identification of a performance obligation

- **Performance obligation**: promise in a contract with a customer to transfer an asset (such as a good or a service) to that customer.

- A contractual promise can be **explicit or implicit**.

- The promise to provide a **good** is a promise to **transfer an asset** to the customer.

- A promise to provide a **service** is similarly a promise to **transfer an asset**, even though the customer may consume that asset immediately.

Identification of a performance obligation

Multiple element arrangements

- Performance obligations are accounted for separately if the promised assets (goods or services) are **transferred** to the customer **at different times**.

- Performance obligations are separated to ensure that an entity's **revenue faithfully represents the pattern of the transfer of assets** to the customer over the life of the contract.

Satisfaction of a performance obligation

General Principle

- **Revenue is recognised on satisfaction of a performance obligation.**

- A performance obligation is satisfied when the entity **transfers** a **promised asset** to the customer.

- An entity has transferred that promised asset when the **customer obtains control** of it.

Satisfaction of a performance obligation

Sale of goods

- A performance obligation is satisfied when the **customer obtains control** of the goods so that the goods are the *customer's* assets.

- Typically, that occurs when the customer takes **physical possession** of the goods.

Satisfaction of a performance obligation

Services

- A performance obligation is satisfied when the **service is the customer's asset**.
- That occurs when the customer has **received the promised service**.
  - In some cases, that service **enhances an existing asset** of the customer.
  - In other cases, that service is **consumed immediately** and would not be recognised as an asset.

Satisfaction of a performance obligation

Construction contracts

- **Activities** that an entity undertakes in fulfilling a contract result in **revenue** recognition only if they **simultaneously transfer assets to the customer**.

- In a contract to construct an asset for a customer, an entity satisfies a performance obligation during construction only if **assets** are **transferred to the customer throughout the construction process**.

- That would be the case if the **customer controls the partially constructed asset** so that it is the customer's asset as it is being constructed.

Measurement

Measurement

Objective of measuring a performance obligation

- To recognise a contract, an entity **measures its rights and its performance obligations** in the contract.

- The boards have **not yet expressed a preliminary view** on how an entity would measure the rights.

- However, measurement of the rights would be **based on the amount of the transaction price** (ie the promised consideration).

Measurement

Initial measurement of a performance obligation

- The boards propose that performance obligations initially should **be measured at the transaction price** – the customer's promised consideration.

- If a contract comprises **more than one performance obligation**, an entity would **allocate the transaction price** to the performance obligations on the basis of the relative stand-alone selling prices of the goods and services underlying those performance obligations.

Measurement

Subsequent measurement of a performance obligation

- Subsequent measurement of the performance obligations should depict the **decrease in the entity's obligation to transfer goods and services** to the customer.

- When a performance obligation is satisfied, the **amount of revenue recognised is the amount of the transaction price** that was allocated to the satisfied performance obligation at contract inception.

- Consequently, the **total amount of revenue** that an entity recognises over the life of the contract is **equal to the transaction price**.

Measurement

Remeasurement of a performance obligation

- The boards propose that after contract inception, the **measurement of a performance obligation should not be updated** unless that performance obligation is deemed onerous.

- A performance obligation is **deemed onerous** when an entity's **expected cost** of satisfying the performance obligation **exceeds the carrying amount** of that performance obligation.

- In that case, the performance obligation is **remeasured to the entity's expected cost** of satisfying the performance obligation and the entity would **recognise a contract loss**.

Potential effects on present practice

Use of a contract-based revenue recognition principle

- Revenue is recognised if an increase in a net position occurs in a contract with a customer as a result of satisfying a performance obligation.

- **Increases in other assets** such as cash, inventory in the absence of a contract with a customer, and inventory under a contract with a customer (but not yet transferred to the customer) would **not trigger revenue recognition**.

- For instance, entities that at present recognise **revenue for construction-type contracts** would recognise revenue during construction only if the customer controls the item as it is constructed.

Identification of a performance obligation

- In **present practice**, entities sometimes account for similar contractual promises differently.

- For example, some **warranties** and other **post-delivery services** are accounted for as **cost accruals** rather than as ‘deliverables’ in or ‘components’ of a contract.

- In the proposed model, entities would **account for those obligations as performance obligations** and would **recognise revenue as they are satisfied**.

Use of estimates

- Some **existing standards limit the use of estimates** more than the boards' proposed model would.

- For example, entities sometimes do not recognise revenue for a **delivered item** if there is **no objective and reliable evidence of the selling price** of the undelivered items (eg EITF Issue No. 00-21 *Revenue Arrangements with Multiple Deliverables* and AICPA SOP 97-2 *Software Revenue Recognition).*

- In contrast, in the proposed model, entities would **estimate the stand-alone selling prices** of the undelivered goods and services and recognise revenue when goods and services are delivered to the customer.

Capitalisation of costs

- At present, entities sometimes capitalise the **costs of obtaining contracts**.

- In the proposed model, costs are **capitalised only** if they **qualify for capitalisation** in accordance with other standards.

- For example, **commissions paid to a salesperson** for obtaining a contract with a customer **typically do not create an asset** qualifying for recognition in accordance with other standards.

- As a result, an entity would **recognise** such costs **as expenses** as incurred, which may not be in the same period in which revenue is recognised.

Examples

ToolCo – Case I

ToolCo sells power tools. To encourage customers to make purchases, ToolCo allows them to return the tools within 30 days of purchase and to receive a full refund of the purchase price.

- ➢ customer controls the tool at the point of delivery
- ➢ tool is the customer's asset and ToolCo no longer has enforceable rights to it
- ➢ customer bears some risks of owning the tool, such as the risk of loss or theft
- ➢ ToolCo bears other risks, such as the risk that the tool will be returned

→ Nevertheless, asset transferred to the customer

→ Revenue to be recognised upon delivery regardless of the possible return

ToolCo – Case II

ToolCo sells power tools. To encourage customers to make purchases, ToolCo allows them to use the tools on a trial basis for 30 days. ToolCo can take possession of a tool at any time during the trial period and is entitled to full payment if the tool is not returned within 30 days.

- ➢ tool is ToolCo's asset until the expiry of the 30-day trial period (enforceable right)
- ➢ not likelihood of return that determines which entity has the asset
- ➢ decision rather based on which entity controls the tool

→ Tool not transferred

→ No revenue to be recognized

Note: judgement could vary among jurisdictions

Discussion of proposed model against PAAinE DP on RR

Assets/Liabilities-Approach

= revenue is measurable changes in assets and liabilities

Critical events approach
(similar to IAS 18)

revenue = arises when the supplier fulfils the performance obligations arising under a contract

Continuous approach
(similar to IAS 11)

revenue = measured progress towards contract completion (percentage of completion)

Approach I_A

fulfils all performance obligations

Approach I_B

fulfils all performance obligations under a part-contract (part-contract as defined by contract)

Approach I_C

substantively fulfils performance obligations of part-contract (part-contract as defined by economic measures)

Approach II

recognised continuously over the course of contract, as the contract progresses and the entity perfoms

Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany ®

Zimmerstraße 30

10969 Berlin

Tel. 030 20 64 12 12

Fax 030 20 64 12 15

www.drsc.de

info@drsc.de