



# Revenue Working Group Re-exposure of proposals

Prepared by ASBJ and ASC Singapore

**Note:**

This presentation is developed based on the pre-ballot draft of the revised exposure draft, “*Revenue from Contracts with Customers*”, that is available through the NSS website.

The analysis included in the presentation reflect the preliminary views of the technical staff of the working group members and do not necessarily reflect the formal views of each working group member.

# Introduction

- Project status
  - Revised exposure draft issued on 14 November 2011
  - New IFRS expected in the 2<sup>nd</sup> half of 2012
- Key areas for discussion
  - 5 steps in applying the core principle of the proposed revenue recognition model
  - Other issues
- Appendix - Questions on the revised ED

# Core principle

- An entity shall recognise revenue to depict the transfer of promised 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.

# Proposed model – 5 steps

No change from the 2010 ED

Step 1: Identify the contract 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 in the contract

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

# Step 1: Identify the contract(s)

- Combination of contracts
    - Three *criteria* in the revised proposal
  - Segmentation of a contract – **eliminated** in the revised proposal
  - Contract modification
- ✓ *WG members do not disagree with the revised proposal in this step.*

## Step 2: Identify the separate performance obligations

- If goods or services in a contract are “distinct”, then account for as separate performance obligations.
- “Distinct” if -
  - The entity regularly sells the good or service separately, or
  - The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer.

## Step 2: Identify the separate performance obligations

- A good or service in a bundle of promised goods or services is **not distinct** and, hence, the entity would account for the bundle as a single performance obligation, if **both** of the following criteria are met:
  - The goods or services in the bundle are *highly interrelated* and transferring them to the customer requires the entity also to provide a *significant service of integrating* the goods or services into the combined item(s) for which the customer has contracted; and
  - The bundle of goods or services is *significantly modified or customized* to fulfil the contract.



## Step 2: Identify the separate performance obligation

- Most WG members support the revised proposal.
- However, there are some concerns:
  - The concept of “business model” ought to be taken into account in identifying the separate performance obligations.
  - “Standing ready” notion in para.26(d) is not clear
  - Potential interpretation issue in para.25 – the meaning of “activity”

# Step 3: Determine the transaction price

- Variable consideration
  - Constraining the cumulative amount of revenue recognised ... *Q3 in revised ED*
- Time value of money
- Non-cash consideration
- Consideration payable to a customer
- Collectibility (Presentation of credit risk) ... *Q2 in revised ED*

## Variable consideration – Constraint on revenue recognition (1/2)

- Some WG members disagree with the constraint.
- Why?
  - “Reasonably assured” criterion seems to relate to the likelihood-based criterion in paragraph 4.38(a) of the IASB Conceptual Framework but with a higher threshold than the “probable” threshold. This could impose a conservative bias to revenue recognition.

(...continued)

## Variable consideration – Constraint on revenue recognition (2/2)

- Why?
  - Concern on how the “reasonably assured” criterion interacts with the proposal that an entity shall “estimate the amount it will be entitled”.
  - The constraint appears unduly restrictive.

# Collectibility

- Most WG members fundamentally disagree with reflecting customers' credit risks as contra-revenue (*presenting as a separate line item adjacent to the revenue*) as it contradicts the core revenue recognition principle (recognise revenue in an amount that an entity *expects to be entitled*).
- These WG members consider that credit risks should be classified **as an expense**.

# Step 4 : Allocate the transaction price

- Allocate based on relative stand-alone selling price at contract inception.
- If a stand-alone selling price is not directly observable, an entity shall estimate it. Estimation methods include:
  - Adjusted market assessment approach
  - Expected cost plus a margin approach
  - **Residual approach**
- WG members generally do not have any concerns with the revised proposal except that some members are of the view that customary business practice/entity's pricing methodologies should be taken into account in the allocation of the transaction price, primarily in the allocation of a discount to separate performance obligations.

# Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

## **PO satisfied “over time” criteria (At least one of the 2 criteria is met)**

- a. Paragraph 35(a): The entity’s performance creates or enhances an asset (e.g. work in progress) that the customer controls as the asset is created or enhanced.
- b. Paragraph 35(b): The entity’s performance does not create an asset with alternative use to the entity and at least one of the following criteria is met:
  - i. The customer simultaneously receives and consumes the benefits of the entity’s performance as the entity performs.
  - ii. Another entity would not need to substantially reperform the work the entity has completed to date.
  - iii. The entity has a right to payment for performance to date and it expects to fulfill the contract as promised.

# Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

- Performance Obligations (PO) satisfied over time (2 criteria, see next slide) ... Q1 in revised ED.
- If a PO is not satisfied over time, the PO is satisfied at a point in time. 5 indicators of control but not to be taken as a comprehensive checklist:
  - Present right to payment.
  - Legal title.
  - Physical possession.
  - Significant risks and rewards of ownership of the asset.
  - Customer acceptance.



# Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

- **Most WG members do not object with the revised proposal.**
- **However, they have concerns on certain aspects of the revised criteria for revenue recognition for POs satisfied over time.**
- Five broad issues are highlighted.
  - (A) Clarification on the interaction of paragraph 35(b) with the core principle of revenue recognition.
  - (B) Clarification on the application of the alternative use criterion.
  - (C) Potential broadening of continuous recognition of revenue to more contracts than intended.
  - (D) Clarification of paragraphs 35(b)(i) and 35(b)(ii).
  - (E) Implications on multi-unit multi-level real estate sales in Asia-Oceania.

# Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

## (A) Clarification on the interaction of paragraph 35(b) with the core principle of revenue recognition

- **Some WG members expressed concerns on how the alternative use criterion reconciles to the core principle of recognising revenue when the customer obtains control of that good or service.**
  - Example 1: For audit services, if the entity satisfied the alternative use criterion and b(iii), it is not clear how the customer had obtained control of that audit service rendered before its completion.
  - Example 2: If the entity satisfied the alternative use criterion and b(ii) but not b(i), this appears inconsistent with the core principle.
- **Clarification is needed on how the satisfaction of paragraph 35(b) will meet the core principle.**

# Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

## (B) Clarification on the application of the alternative use criterion

- Most WG members do not disagree with the alternative use criterion. However, clarification is needed on its application.
- Present guidance include:
  - Whether the entity is able, either contractually or practically, to readily direct the asset to another customer.
  - Interchangeability of asset with other assets that the entity could transfer to the customer without breaching the contract or incurring significant cost (e.g. cost to rework the asset).
- Alternative use criterion is easy to apply in the 2 extreme situations:
  - A mass market homogeneous product (e.g. automobiles) – asset has alternative use.
  - A specific/highly customised asset (e.g. system development that only a customer could use) – asset does not have any alternative use.

# Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

## (B) Clarification on the application of the alternative use criterion

- However, alternative use is not as clear cut for anything that falls in between these 2 ends of the spectrum and further guidance/clarification is necessary to prevent application divergence.

Alternative use	Is alternative use present?	No alternative use
Mass market products	Built-to-purpose assets	Specific/highly customised asset

- More guidance is needed for assets that do not fall within the 2 extreme situations such as ships and offshore drilling rigs beyond assessing the cost of rework. For example, would the following factors affect the alternative use assessment:
  - The ready availability of alternative customers to the entity for the asset
  - Length of contract

# Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

## (C) Potential broadening of continuous recognition of revenue to more contracts than intended

- Some WG members expressed concerns that there is a potential for broadening of continuous revenue recognition based on the revised criteria for POs satisfied over time.
- Specifically, clarification is needed on whether paragraph 35b(ii) is intended to apply to contracts where a tangible asset is created.
  - For instance, if b(ii) applies to such contracts, it is likely that revenue would be recognised continuously for most contracts, including real estate sales even if the entity does not have a right to payment, since another entity is unlikely to have to substantially reperform the work that the entity has completed to date.
  - If b(ii) does not apply to such contracts, there is an inconsistency created as the criterion should apply regardless of whether the asset created is tangible or not.

# Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

## (D) Clarification of paragraphs 35(b)(i) and 35b(ii)

- Clarification is needed on the interaction between paragraphs 35(a) and 35(b)(i).
- Clarification is needed on how “another entity would not have the benefit of any asset presently controlled by the entity” under paragraph 35b(ii) is to be applied.

# Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

## (E) Implications on multi-unit multi-level real estate sales in Asia-Oceania

- **Impact on such transactions in their jurisdictions need to be further analysed by WG members.**
- Illustrative example 7 in the revised ED is appropriate for certain Asia-Oceania real estate sales.
  - However, not all sell then build transactions in Asia-Oceania are considered to be POs satisfied over time.
- Potential for unintended consequences for certain Asia-Oceania real estate sales where revenue is currently recognised upon completion.
  - Criterion of “another entity would not need to substantially reperform the work the entity has completed to date” would impact such transactions if this criterion applies.

# Other Questions in the ED

- Onerous test ... *Q4 in revised ED*
- Interim reporting – disclosure ... *Q5 in revised ED*
- Consequential amendment - Transfer of a non-financial asset that is not an output of an entity's ordinary activities ... *Q6 in revised ED*



# Onerous test

- Some WG members disagree with the scope.

Performance Obligation		
Satisfied Over Time		Satisfied at a point in time
Greater than one year	Within one year	
Onerous Test	No Onerous Test	No Onerous Test

- Why?
  - Onerous test should be applied to all material onerous performance obligations.

# Interim reporting - disclosure

- Some WG members disagree.
- Why?
  - Proposed requirement on disclosure for interim reporting is excessive; in particular -
    - ✓ *Reconciliation of the movements (contract assets, contract liabilities)*
    - ✓ *An analysis of remaining performance obligations*
    - ✓ *Reconciliation of the movements (capitalized contract cost)*

# Consequential amendment

- Application of the proposed requirements to *Transfer of a non-financial asset that is not an output of an entity's ordinary activities (IAS16, IAS40)*
- Most WG members agree but some members have concerns.
- Why?
  - If consequential amendments to IAS 16 relate to paras.68A and 69, we could not assess the potential impact on assets under finance lease because of the current ongoing discussion of the lease project.

# Other Issues

- Sale and repurchase agreements
- Islamic contract and revenue recognition
- Scope
- Input vs. Output methods
- Time value of money
- Increased use of ‘practical expedients’
- Wording in paras.31 to 34 – too “business-to-business”
- SIC 31 – Barter transactions involving advertising – very little in the ED



A lot of  
other  
concerns!

# Next Steps

- We will review the revised ED and update the analysis.
- AOSSG Revenue Working Group will prepare a draft comment letter by end of January 2012.
- We will finalize the comment letter and submit it to the IASB by 13 March 2012.
- We will post the comment letter on the AOSSG website.



# Revenue Working Group Members

- AASB, Australia
- ASBJ, Japan - *Chair*
- ASC, Singapore - *Co-Chair*
- CASC, China
- CRAC, Macau
- HKICPA, Hong Kong
- IIA, Indonesia
- KASB, Korea - *New*
- MASB, Malaysia
- NZICA, New Zealand

# Questions?



## Contact:

- Kuniko Isaka, ASBJ
- Takehiro Okamoto, ASBJ
- Ivan Koo, ASC, Singapore
- Suat Cheng Goh, ASC, Singapore

# **APPENDIX**

## **Questions on the Revised ED**



# Q1: Control transfers “over time”

- Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time.
- Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

## Q2: Presentation of credit risk

- Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, *if the entity has not yet adopted IFRS 9*) to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item.
- Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

## Q3: Variable consideration

- Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should 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 allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.
- Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

## Q4: Onerous test

- For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous.
- Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

## Q5: Interim reporting - Disclosure

- The boards propose to amend IAS 34 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports.\* The disclosures that would be required (if material) are:
  - The disaggregation of revenue
  - A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period
  - An analysis of the entity's remaining performance obligations
  - Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period

(... Continued)

## Q5: Interim reporting - Disclosure

(... Continued )

- A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer.
- Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.

## Q6: Derecognition of assets

- For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset.
- Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

