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IFRS bulletin from PwC

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IASB and FASB issue new revenue recognition exposure draft

What is the issue?

The IASB and FASB have issued a new exposure draft (ED) on revenue from contracts with customers. The core revenue recognition model and scope have not changed from that proposed in the June 2010 ED. However, the boards have revised various proposals on how to apply that core principle. They therefore agreed that re-exposure would increase transparency and minimise unintended consequences. The comment period ends on 13 March 2012.

The new ED requests feedback on the most significant changes from the previous proposal; these are summarised below.

The proposed model

The proposed model requires a contract-based approach. Management should first identify separate performance obligations and then estimate and allocate the transaction price to each separate performance obligation. Revenue is recognised when an entity satisfies its obligations by transferring control of a good or service to a customer. There are a number of changes from the June 2010 ED. Most of the changes were made in response to concerns raised during the comment letter process and industry consultation.

Performance obligations satisfied over time

The ED provides new guidance on determining when a performance obligation is satisfied 'over time' rather than at a 'point in time'. A performance obligation is satisfied over time if the entity's performance:

- creates or enhances an asset that the customer controls; or
- does not create an asset or creates an asset but the asset has no alternative use to the vendor, and one of the following criteria is met:
  (a) the customer simultaneously receives and consumes the benefit as the entity performs;
  (b) another entity would not need to substantially re-perform tasks already performed; or
  (c) the entity has a right to payment for work performed.

Presentation of the effects of credit risk

Impairment as a result of credit risk is presented as a separate line item adjacent to revenue. Both the initial impairment assessment and any subsequent changes in the estimate are recorded in this line item, such that the cash ultimately received from the customer equals the sum of the two line items if the contract does not have a significant financing component.

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‘Reasonably assured’ constraint

Revenue is only recognised to the extent that the entity is reasonably assured to be entitled to the consideration. An entity is reasonably assured when it has experience with similar types of performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled.

The new ED includes an exception for licences of intellectual property, such that consideration based on the customer’s subsequent sales using that intellectual property cannot be recognised as revenue until those subsequent sales occur.

Onerous performance obligations

An entity recognises a loss for a performance obligation that is satisfied over a period greater than one year if the performance obligation is onerous. A performance obligation is onerous if the lower of the cost to settle or fulfil the performance obligation exceeds the transaction price allocated to that performance obligation. The new ED removes the requirement from the previous proposal to assess and measure a liability for a performance obligation satisfied at a point in time or within a year.

Interim disclosures

Several new disclosures will be required not only in an entity’s annual financial statements, but also in its interim financial statements.

Application to non-financial assets

The new ED will result in entities recognising the sale of a non-financial asset when control is transferred to the buyer even if the sale is outside of the scope of the ED (that is, not a contract with a customer).

Is convergence achieved?

Convergence is expected for revenue recognition, as the same principles should be applied to similar transactions under both frameworks. Differences might continue to exist to the extent that the guidance requires reference to other standards before applying the guidance in the revenue standard.

Who’s affected?

The proposal will affect most entities that apply IFRS or US GAAP. Entities that currently follow industry-specific guidance should expect the greatest impact.

What’s the effective date?

The final standard will have an effective date no earlier than 2015. Full retrospective application will be required, with the option to apply some transition relief.

What’s next?

The comment period ends on 13 March 2012; we understand the boards anticipate issuing the final standard by the end of 2012. We will issue a ‘Practical guide’ shortly with more comprehensive analysis of the ED.