Straight away
An overview of financial reporting developments

IASB and FASB debate revenue recognition and reach agreement on key issues

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What's new?

The IASB and FASB (together 'the boards') recently reached a number of decisions regarding their project on revenue recognition. The boards addressed two fundamental issues: identifying separate performance obligations and determining when control over goods or service is transferred. The boards also reached decisions on other key areas. These decisions are tentative and subject to change. A number of issues remain to be redeliberated, including allocation of transaction price, variable consideration, accounting for licenses, disclosure and transition.

Key Provisions

Identification of separate performance obligations

Performance obligations are promises in a contract to transfer goods or services to a customer. The boards did not fundamentally change the definition of a performance obligation, but they did modify the definition to delete 'enforceable' and clarify that promises implied by an entity's business practices are performance obligations if they create expectations of performance.

The boards also tackled the identification of a 'distinct' performance obligation that should be accounted for separately. Constituents told the boards that the original proposal was unclear and impractical in some situations. As a result, the boards have concluded that a distinct performance obligation exists if the entity regularly sells the good or service separately, or the customer can use the good or service on its own or together with resources readily available to the customer. The boards also decided that a bundle of goods or services should be accounted for together as one if the entity integrates those goods or services into a single item provided to the customer.

Transfer of goods and services

The exposure draft requires that revenue be recognised when control of goods or services transfers to a customer and a performance obligation is satisfied. The boards confirmed this principle, but agreed to modify the indicators for determining when control transfers. They plan to add 'transfer of risks and rewards of ownership' as an indicator of control, and eliminate 'the design or function of the good or service is customer-specific'.

The boards also proposed new guidance for accounting for services. A service is satisfied continuously if the entity creates or enhances an asset that the customer controls. The boards also concluded that a service might be satisfied continuously even if performance does not create an asset that the entity can otherwise use if: the customer immediately receives a benefit from the tasks the entity performs; another entity would not need to reperform tasks already performed if it took on the remaining obligations to the customer; or the entity has a right to payment for work performed.

Other significant decisions

- *Cost of obtaining a contract.*
  Costs to obtain a contract can be capitalised if they are incremental and expected to be recovered. Costs of fulfilling a contract will be discussed at a future meeting.

- *Warranties*
  Only warranties that provide a service in addition to quality assurance should be accounted for as a separate performance obligation. Warranties for quality assurance should be accounted for as a cost accrual similar to current guidance.

- *Onerous contracts*
  Onerous contract provisions will be assessed at the contract level, rather than the performance obligation level. Further debate is expected for contracts that are 'loss leaders' together with costs to be included in the onerous test.

- *Contract combination*
  Interrelated contracts should be combined. Contracts might be interrelated if they are entered into at the same time, generally with the same party, or if other factors indicate they are interrelated.

Am I 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. Further, Ind AS may be subsequently modified due to change in IFRS.

What do I need to do?

The boards' timeline indicates a final standard in June 2011. The boards will continue to re-deliberate over the next few months and perform targeted consultation with key industries and other interested parties for some of the more significant changes.
We anticipate the final standard to have an effective date no earlier than 2014, given the proposed retrospective application of the new model.

If you have questions about this issue, please contact the PwC IFRS team or your engagement partner.