Overview

At their joint meeting in January 2013, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Boards (FASB) (collectively, the Boards) addressed a variety of topics on the proposed revenue standard including:

- The scope of the proposed standard, including for financial services contracts and collaborative arrangements
- The application of constraint on revenue for performance-based fees in the asset management sector
- Accounting for contracts with customers that contain repurchase agreements
- Accounting for transfers of non-financial assets that are not an output of an entity’s ordinary activities

The exposure draft (ED) was re-exposed by the Boards in November 2011. The Boards began re-deliberations in July 2012 and are addressing the issues identified by constituents in comment letters. The Boards are expected to continue re-deliberations next month and are still aiming to issue a new standard in the first half of 2013.

Tentative decisions

Scope

As proposed, the ED would be applicable to all contracts with customers. Some respondents requested clarification and application guidance for determining when a contract is in the scope of the ED.

The Boards tentatively confirmed the scope of the standard as proposed. For financial services contracts involving financial instruments and the transfer of goods or services to a customer, the Boards clarified that entities would identify the portion of the contract that is associated with the financial instruments by first applying the separation and/or measurement requirements of the financial instruments standards. The revenue standard would then be applied to any residual components of the arrangement.
The Boards also tentatively confirmed that transactions with a collaborator or partner may be in the scope of the final standard if the transaction is one between a vendor and customer, as defined in the final standard. Furthermore, the Boards clarified that a collaborative arrangement is not limited to developing a product to be marketed. They also noted that an entity would consider whether a transaction involves the entity’s ordinary activities when determining if a contracted party is a customer.

**Application of the revenue recognition model for asset managers**

Under current IFRS, the majority of asset managers defer recognition of revenue from performance-based fees until the fee can be reliably measured and it is probable it will be received, consistent with the requirements in IAS 18 Revenue and similar to Method 1 in US GAAP. Where there are clawback provisions, recognition is deferred until all contingencies are resolved, which may be at the end of the performance period. A minority of asset managers recognise revenue throughout the period of the contract, based on a liquidation value for the fund, i.e., the fair value of the consideration at each reporting date (similar to Method 2 in US GAAP).

Based on the Boards’ recent re-deliberations, the recognition of revenue would be constrained to the amount that is not subject to significant revenue reversals. Application of the constraint would not typically permit asset managers to recognise revenue in accordance with Method 2. Some asset managers expressed concern that applying the constraint to performance-based fees would not reflect the economics of their transactions.

The Boards tentatively confirmed that the constraint will apply to performance-based incentive fees. The Boards noted that although Method 2 provides a good depiction of an asset manager’s performance in each period, it is not consistent with the objective of the constraint, which is to recognise revenue at an amount that should not be subject to significant revenue reversals.

A number of respondents also raised questions regarding upfront commission costs incurred in an arrangement between an asset manager and a fund when the asset manager agrees to provide various services to the fund. Under the ED, many of these costs could be viewed as contract fulfilment costs, which would be expensed as incurred if the capitalisation criteria are not met. The Boards tentatively agreed not to provide specific application guidance in respect of such commission costs in the final revenue standard. However, in a change from the ED, the FASB tentatively decided to retain their existing requirements for capitalising upfront commission costs, which would allow entities reporting under US GAAP to continue to capitalise these costs. No similar requirements exist under IFRS.

**Repurchase agreements**

The ED would require an entity to account for a transaction with a customer as a lease if the entity is obliged, or has the right, to repurchase an asset at a price less than the original sales price. If the entity is obliged or has the right to repurchase the asset at a price equal to or greater than the original sales price, the entity would account for the arrangement as a financing transaction. Neither of these transactions would be treated as sales because the existence of the obligation, or the right, to repurchase would indicate that control of the asset had not been transferred to the customer. Conversely, an arrangement providing the customer a residual value guarantee would be treated as a sale, as control of the asset has transferred to the buyer.

Certain respondents raised concerns about this aspect of the model. For example, those in the automotive industry questioned the application of this proposed requirement to sales of fleet vehicles. These respondents questioned why the application of the ED to two transactions with similar economics would result in different outcomes. For example, (i) an agreement to repurchase a vehicle from a customer at a price lower than the original sales price; and (ii) a vehicle sale containing a residual value guarantee would result in different outcomes (a lease and a sale, respectively). The Boards tentatively decided that guaranteeing a vehicle’s residual value is economically different from agreeing to repurchase a vehicle at an amount less than the original sales price. However, the Boards acknowledged that the substance of the arrangement would have to be considered. For example, if the entity has provided a residual value guarantee, but is significantly involved in the customer’s subsequent resale of the vehicle, it may be appropriate to account for the arrangement as a lease.

Respondents also asked the Boards about the application of the proposed requirements to equipment that is sold to a dealer, but is subsequently repurchased subject to an operating lease with the dealer’s customer. The Boards tentatively decided that these arrangements can continue to be accounted for as two separate.

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1 Under ASC 605-20-599 (formerly, EITF D-96, Accounting for Management Fees Based on a Formula) in US GAAP, Method 1 and Method 2 are commonly understood in the asset management industry as two acceptable methods for accounting for performance-based fees. Under Method 1, performance fees are recognised once the services are performed and all contingencies have been resolved. Under Method 2, performance fees are recognised throughout the contract, measured based on the amount that would be due from the customer assuming the contract was terminated at that date (i.e., liquidation value). Method 2 can only be used if the contract contains a termination provision.
transactions in situations where control of the equipment transfers to the dealer. For example, when the financing transaction for the sale of the equipment to the end-customer occurs subsequent to the original sale of the equipment to the dealer, the dealer likely obtains control of the equipment. However, when the financing transaction occurs before the original equipment sale to the dealer (e.g., the end-customer orders a customised piece of equipment), the dealer may never have control of the equipment. In such situations, the Boards agreed that the dealer may be acting as an agent on behalf of the manufacturer and the manufacturer would account for both transactions together.

Transfers of non-financial assets that are not an output of an entity’s ordinary activities

Based on the proposed requirements, an entity would apply the control and measurement requirements in the ED to account for transfers of non-financial assets that are not an output of the entity’s ordinary activities (i.e., not revenue). Some entities raised concerns about applying the measurement requirements in the ED to these transfers because, in some instances, it may result in the recognition of a loss upon transfer of the asset. For example, transactions where consideration for the transfer is variable and recognition is constrained because it may be subject to significant reversal.

To address the concerns, the Boards considered requiring these asset transfers to be measured at fair value. However, applying a fair value measurement basis to such transfers would result in inconsistencies in the measurement of consideration for transfers that are an output of an entity’s ordinary activities and those that are not. In addition, fair value measurement would represent a reasonably significant change for those applying US GAAP today. Therefore, the Boards tentatively re-affirmed that an entity would apply the control and measurement requirements in the final standard to transfers of non-financial assets that are not an output of the entity’s ordinary activities.

Transition and disclosure

The Boards also discussed a summary of feedback received on the proposed transition and disclosure requirements in the ED. The Boards were not asked to make any decisions on these topics during this meeting. The Boards plan to re-deliberate these topics at their February meeting.

What’s next

Re-deliberations will continue next month. The Boards are still aiming to issue a new standard in the first half of 2013.

How we see it

There is currently mixed practice on the recognition of day one losses on the transfer of non-financial assets involving variable or contingent consideration. The proposed requirements would eliminate those differences in practice. However, entities may not believe that the recognition of day one losses on the transfer of assets in this type of fact pattern appropriately reflects the economic substance of these arrangements. In such situations, entities may need to consider whether additional disclosure is needed to explain these day one losses to users of the financial statements.
Appendix
The following table updates the Boards’ re-deliberations plan

<table>
<thead>
<tr>
<th>Re-deliberation topic</th>
<th>July 2012</th>
<th>September 2012</th>
<th>October 2012</th>
<th>November 2012</th>
<th>December 2012</th>
<th>January 2012</th>
<th>Future meeting(s)</th>
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<tbody>
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<td>Identification of separate performance obligations</td>
<td>Time value of money</td>
<td>Contract modifications</td>
<td>Collectibility</td>
<td>Constrained the cumulative amount of revenue recognised</td>
<td>Scope and other issues</td>
<td>Disclosure</td>
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<td>Satisfaction of performance obligations</td>
<td>Contracts with customers that contain nonrecourse, seller-based financing</td>
<td>Measures of progress</td>
<td>Constrained the cumulative amount of revenue recognised – licences</td>
<td>Contract acquisition costs</td>
<td>Non-financial assets</td>
<td>Transition, effective date and early adoption</td>
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<tr>
<td></td>
<td>Onerous test</td>
<td>Contract issues – contract combination and distribution networks</td>
<td>Measures of progress</td>
<td>Licences*</td>
<td>Allocating the transaction price, including the effect on some bundled arrangements</td>
<td>Disclosure and transition outreach update (no decisions made)</td>
<td>Sweep issues and consequential amendments</td>
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Future meeting(s)
- Disclosure
- Transition, effective date and early adoption
- Sweep issues and consequential amendments
- Cost-benefit analysis

* The staffs will perform additional outreach on the indicators for determining whether a licence represents a performance obligation satisfied at a point in time or over time.