IFRS Developments

Final revenue standard is taking shape

What you need to know

► The IASB and the FASB have completed their substantive re-deliberations on a comprehensive new revenue recognition standard that they expect to issue in the coming months.
► The result of their re-deliberations will be a single revenue standard for all entities that follow IFRS or US GAAP.
► To give entities time to implement systems, gather data and resolve implementation questions, the IASB has set an effective date of 1 January 2017. The FASB has set an effective date of annual periods beginning on or after 15 December 2016.
► Implementation questions are likely, given the principles-based approach of the new standard. However, in certain areas (e.g., multiple-element arrangements), the new standard will set out more explicit requirements, compared with those currently in IFRS.

Highlights

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (collectively, the Boards) have completed their substantive re-deliberations on a comprehensive new revenue recognition standard that will apply to all entities that follow either IFRS or US GAAP. This publication summarises the Boards' decisions to date and discusses the remaining topics that the Boards will address over the next few months.

One of the significant decisions that the Boards made was to determine an effective date. Because entities need time to adopt the new standard, the Boards decided to provide constituents with considerable lead time. The IASB has set an effective date of 1 January 2017, with early adoption permitted (following a reversal of its previous decision to disallow early adoption by existing IFRS preparers). The FASB has set an effective date of annual periods beginning on or after 15 December 2016.

Most of the Boards' tentative decisions in the re-deliberations sought to clarify the principles in the 2011 exposure draft (ED) rather than change them. These clarifications are being made as part of drafting the final standard. However, the Boards have made some significant changes to their proposal, which are discussed in the following sections.

Aspects of the model that have changed

Onerous performance obligations

One contentious aspect of the ED was the requirement for entities to recognise a liability and corresponding expense for onerous performance obligations satisfied over a period of greater than one year. Many respondents disagreed with this approach, which could have resulted in onerous performance obligations being recognised for overall profitable contracts. In response, the Boards tentatively decided to remove this requirement from the standard.
Instead, the Boards indicated that existing IFRS and US GAAP requirements for onerous contracts will continue to apply. That is, for IFRS reporters, the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets will continue to apply. The FASB also tentatively decided to consider developing new requirements for onerous contracts.

Constraining the cumulative amount of revenue recognised

During re-deliberations, the Boards tentatively decided that the proposed constraint on recognising variable consideration should be applied by an entity when it estimates the transaction price. In the ED, the Boards had proposed that the constraint be applied by an entity when it satisfies its performance obligations. However, the Boards instructed their staffs to consider whether this decision would create any unintended consequences.

How we see it

Applying the proposed constraint on variable consideration when estimating the transaction price could result in a change for some entities. For example, it is unclear how this constraint would be applied by long-term construction contractors that frequently change their estimates of total consideration.

The Boards also tentatively decided to eliminate the specific constraint in the ED (paragraph 85) for sales-based royalties on licensed intellectual property. Instead, the Boards intend to further clarify the indicators for determining whether an entity has relevant experience to predict the amount of consideration to which it will be entitled from sales-based royalty arrangements.

Collectibility

The Boards tentatively decided that the effects of customer credit risk (related to contracts with and without significant financing components) should be presented prominently as a separate line item in expenses in the statement of comprehensive income, rather than adjacent to revenue. This tentative decision would generally align the presentation of customer credit risk with the current practice of presenting bad debts as an expense. Today, however, few entities present these amounts as a separate line item on the face of the statement of comprehensive income.

This is a change from the ED, which would have required the effects of customer credit risk in contracts without significant financing components to be presented in a separate line item adjacent to revenue and customer credit risk in contracts with a significant financing component as an operating expense.

Transition

The Boards tentatively decided to allow either full retrospective application of the new standard or a modified retrospective approach. This is a change from the ED, which would have required retrospective application in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, with only limited relief available.

Under the modified retrospective approach, entities would:

- Present comparative periods under current IFRS revenue requirements
- Apply the new standard to new and existing contracts as at the effective date
- Recognise a cumulative catch-up adjustment to the opening balance of retained earnings at the effective date for existing contracts that still require performance by the entity
- Disclose all line items in the year of adoption as if they were prepared under current IFRS revenue requirements

The standard will allow either full retrospective application or a modified retrospective approach.
Disclosure
The Boards made a number of changes to the proposed disclosures.

Disaggregation of revenue
The Boards had previously proposed in the ED that revenue be presented in categories such as the type of good or service, the country or region, the type of customer and contract, the timing of transfer, the contract duration or the sales channel. These disclosures were intended to illustrate how economic factors affect the nature, amount, timing and uncertainty of revenue.

To address concerns raised by preparers and users of financial statements, the Boards tentatively decided that when determining the level of disaggregation, an entity should consider how management and market participants analyse revenue. The Boards also tentatively decided that entities should discuss how their disaggregated revenue disclosures relate to their segment disclosures.

Reconciliations of contract balance and contract costs
The Boards tentatively decided to require narrative explanations of changes in contract asset and liability balances, rather than the tabular disclosures they had proposed in the ED. These narrative disclosures would include:

- Opening and closing balances of an entity's contract assets, contract liabilities and trade receivables (if not disclosed elsewhere)
- An explanation of any unusual or non-recurring changes in contract balances
- Revenue recognised in the current period for performance obligations settled in previous periods
- Revenue recognised in the current period that had been deferred in previous periods

The Boards tentatively decided not to require reconciliations of costs to obtain or fulfil a contract. Instead, the Boards decided to require disclosure of certain qualitative and quantitative information about the costs to obtain or fulfil a contract.

Interim disclosure requirements
In a change from the ED, the IASB tentatively decided that entities would be required to disclose only the disaggregation of revenue in their interim financial statements, in addition to the existing interim reporting requirements. In contrast to the IASB's decision, the FASB tentatively decided to require entities to disclose in their interim financial statements, the disaggregation of revenue, the balance of contract assets and contract liabilities along with an explanation of unusual or non-recurring movements in those balances, and an analysis of the entity's remaining performance obligations.

How we see it
The new standard may significantly increase the volume of required disclosures that entities applying IFRS will have to include in their annual financial statements. During the transition period, entities will need to ensure that their systems can properly capture the data needed to comply with these requirements.

The IASB's decision to require only disaggregated revenue information in addition to existing interim disclosure requirements represents the only significant difference between the two standards. It is not yet clear whether the IASB or FASB will change its view to achieve converged interim disclosure requirements.
Areas still to be addressed
The Boards still need to address the treatment of licences of intellectual property and other issues.

Licences of intellectual property
In response to constituents’ concerns, the Boards have instructed their staffs to explore a dual approach that would allow entities to recognise revenue from licences of intellectual property over time or at a point in time, depending on the characteristics of the intellectual property and the entity’s continuing involvement. The staffs have been developing indicators that would help entities make this determination. The staffs have also been conducting outreach to determine whether this dual approach is operational and could be applied consistently.

In the ED, the Boards had proposed requiring consideration associated with licences of intellectual property to be recognised at the point in time when the customer obtained the right to use and benefit from the asset. Respondents said that it is frequently difficult to determine when the underlying rights of a licence transfer to the customer and when the seller has satisfied its obligations.

Application guidance
The Boards still need to determine how much application guidance to provide in the final standard. Many respondents requested more application guidance. During re-deliberations, the Boards also noted certain areas where additional application guidance might be helpful (e.g., applying the constraint to sales-based royalties on licensed intellectual property, determining whether performance obligations are satisfied over time or at a point in time).

Sweep issues and consequential amendments
The Boards still have to address the costs and benefits of applying the model and the changes to existing requirements (consequential amendments) that would be required. The Boards may provide additional application guidance.

What’s next
The Boards intend to work through the remaining items and complete drafting in the next few months. They plan to issue a new standard by the middle of 2013.

How we see it
We applaud the Boards’ efforts to thoroughly consider the alternatives and understand the concerns constituents raised about the ED. However, if operational, we are concerned that the dual approach may not be applied consistently to all licence arrangements.

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