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IFRS Developments

Boards conclude re-deliberations on revenue recognition

What you need to know

- In response to concerns raised by constituents, the IASB and the FASB set thresholds for determining the extent to which an entity would include variable consideration in the transaction price and when a contract would be in the scope of the revenue standard, based on collectibility.
- The Boards provided an exception for application of the constraint on estimates of variable consideration to sales and usage-based royalties on all licensed intellectual property.
- The Boards decided to clarify the criteria that entities would use to determine whether to recognise revenue from licences of intellectual property at a point in time or over time.
- The Boards concluded re-deliberations and will work to finalise the standard. The Boards are not likely to issue a standard before early 2014.

The Boards' decisions should help entities apply the requirements, but significant judgement would be required

Highlights

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) (collectively, the Boards) have addressed several outstanding issues on their joint revenue recognition standard that were identified while drafting the standard.

At the October 2013 meeting, the Boards reached tentative decisions on both the proposed constraint on estimates of variable consideration and how assessments of a customer's credit risk should be reflected in the accounting for contracts with customers.

The Boards also decided to have their staffs draft clarifications to assist in determining when revenue from a licence of intellectual property would be recognised at a point in time and when it would be recognised over time. The Boards discussed this topic again to address concerns raised by constituents about the operationality of the licensing requirements.

The IASB and the FASB will complete the remaining due process steps and work to finalise the standard. The Boards are not likely to issue a standard before early 2014.

Building a better working world

Identifying the contract

Collectibility

The Boards tentatively decided to set a collectibility threshold that determines when the standard would apply to a contract. The threshold would require an entity to conclude that it is 'probable' that it will collect the consideration to which it is entitled before the standard could be applied to the contract. In evaluating whether collection is probable, an entity would consider both the customer's ability and intention to pay the amount of consideration when due. A collectibility threshold of 'probable' would be used by both IFRS and US GAAP preparers. However, the term would be used in a manner consistent with the existing definitions of 'probable' in IFRS and US GAAP, respectively, which differ.

The Boards' 2011 exposure draft (ED) did not include an explicit collectibility threshold. Instead, it said that any significant concerns at contract inception about a customer's credit risk might call into question whether the contract should be accounted for under the revenue standard because the customer might not be committed to fulfil its obligations under the contract. Some constituents expressed concern that the quality of revenue could be adversely affected if an entity could recognise revenue from customers that may not have the ability or the intention to pay the promised consideration.

The Boards also tentatively decided to clarify what to do if an entity expects that it will ultimately receive less than the full amount of consideration to which it is entitled. Such a difference would be accounted for as either variable consideration (i.e., a price concession or a discount) or a bad debt expense.

Determining the transaction price

Constraint on estimates of variable consideration

The Boards tentatively decided to require an entity to include an amount of variable consideration in the transaction price, but only to the extent it is 'highly probable' that a subsequent change in estimated variable consideration would not result in a significant revenue reversal. A defined confidence level of 'probable' would be used for financial statements prepared in accordance with US GAAP, which would have the same meaning as 'highly probable' in IFRS. The standard would clarify that a significant reversal occurs when a change in the estimate results in a significant downward adjustment in the amount of cumulative revenue recognised from that contract with that customer.

In making their tentative decision, the Boards responded to requests from constituents during the drafting process for more precision about the level of confidence needed to apply the proposed constraint on variable consideration. The Boards had previously said the transaction price would not include amounts of variable consideration that could result in a significant revenue reversal. In addition, they had agreed that an entity would include a portion of variable consideration (i.e., a minimum amount) if a subsequent change in its estimate of variable consideration would not result in a significant reversal of that amount.

The Boards also tentatively decided to include an exception for sales or usage-based royalties from all licences of intellectual property. An entity would not include an estimate of sales or usage-based royalties in the transaction price until a customer subsequently sells or uses the licensed product. This decision is consistent with the approach proposed in the Boards' 2011 ED.

Licences of intellectual property

The Boards had previously decided that revenue from licences of intellectual property would be recognised at either a point in time or over time, depending on the nature of the right conveyed by the licence. This would result in two types of licences: those that convey a right to use and those that convey a right to access the underlying intellectual property, respectively.

Constituents had concerns about the operationality of the criteria the staffs had developed for determining the nature of the right conveyed. In response, the Boards tentatively agreed to clarify the criteria. The Boards also agreed to clarify that the standard would emphasise the importance of identifying performance obligations in a contract before applying the criteria to distinguish between the two types of licences.

How we see it

We applaud the Boards' efforts to address constituents' concerns on these topics. We believe the decisions reached represent an improvement on the previous tentative decisions. However, significant judgement will be required to apply the proposed requirements, particularly the criteria for determining the nature of a right conveyed in the transfer of a licence of intellectual property.

Next Steps

The Boards indicated that they have concluded re-deliberations and will now work to finalise the standard. The Boards have not indicated whether they will revisit the effective date of the standard now that issuance has been delayed.

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