Practical guide to IFRS

Revenue from contracts with customers

Boards finalise redeliberations – A comprehensive look at the new revenue model

March 2013

Overview

At a glance

- The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (the 'boards') substantively concluded redeliberations of their joint 2011 exposure draft, 'Revenue from contracts with customers', in February. The boards reached decisions on the remaining key issues including disclosures, transition, and effective date at their most recent meetings.

- Details of these decisions, as well as a comprehensive look at the model at the end of the key redeliberations, are included in this practical guide. Any remaining 'sweep' or new issues identified by the boards will be discussed at future board meetings, as needed.

- The boards' timeline indicates the final standard is expected in the second quarter of 2013. The standard will be effective for the first interim period within annual reporting periods beginning on or after 1 January 2017.

- Entities will have the option to apply the final standard retrospectively or use a simplified transition method. An entity will not restate prior periods if it uses the simplified method.

Background

1. The boards believe a single, comprehensive revenue recognition model for all contracts with customers will lead to greater consistency in the recognition and presentation of revenue and will improve comparability within industries, across industries and across capital markets.

2. The standard will contain principles that an entity will apply to determine the measurement of revenue and timing of when it is recognised. The underlying principle is that an entity will recognise revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services.

3. This practical guide summarises the new revenue recognition model based on the tentative decisions to date. Key changes from the exposure draft issued in 2011 are summarised in the appendix to this practical guide. These decisions are tentative and subject to change until a final standard is issued. Changes to decisions made by the boards, including changes to criteria and indicators, might occur during the drafting process. We encourage entities to use this document only as a guideline until the final standard is issued.

PwC observation:

The standard could significantly change how many entities recognise revenue, especially those that currently apply industry-specific guidance. The standard will also result in a significant increase in the volume of disclosures related to revenue.

All entities will likely have to consider changes to information technology systems, processes, and internal controls as a result of the increased disclosure requirements, among other aspects of the model.

Management will need to perform a comprehensive review of existing contracts, business models, company practices, accounting policies, information technology systems, and internal processes and controls to assess the extent of changes needed as a result of the new standard. This may be the case even if the entity's revenue recognition model has not significantly changed.

The following areas of the guidance, among others, could result in significant changes from current practice and an increase in the use of estimates:

- determining a stand-alone selling price;
- licensing and rights to use;
- accounting for contract related costs
- accounting for variable consideration;
- accounting for contract options; and
- reflecting time value of money.

Scope

4. The standard will apply to an entity's contracts with customers, except for:

   - lease contracts;
   - insurance contracts;
   - certain contractual rights or obligations within the scope of other standards including financial instruments;
   - certain guarantees within the scope of other standards (other than product warranties); and
   - nonmonetary exchanges between entities in the same line of business to facilitate sales to customers.

5. Some contracts might include components that are in the scope of the revenue standard and other components that are in the scope of other standards (for example, a contract that includes both a lease and maintenance services). An entity will apply the separation and/or measurement guidance in other applicable standards first and then apply the guidance in the revenue standard. An entity will apply the revenue standard if the other standard does not include separation and/or measurement guidance.

6. The revenue standard will apply to all contracts with customers, including transactions with collaborators or partners if they are in substance transactions with a customer.

PwC observation:

Management will need to evaluate arrangements with collaborators and partners carefully to identify whether such arrangements or portions thereof are in the scope of the revenue standard. A transaction that might be outside the scope of the revenue standard is one with a collaborator or partner that shares risk in developing a product and that is not for the sale of goods or services that are an output of the entity's ordinary activities, and therefore not a contract with a customer.

For example, a biotechnology entity that has an agreement with a pharmaceutical entity to share equally in the development of a specific drug candidate likely will not be in the scope of the standard because the parties share the risk in developing the drug. If, however, the substance of the arrangement is that the biotechnology entity is selling its compound to the pharmaceutical entity and/or providing research and development services, it will likely be in scope.

The five-step approach

7. The standard will require a five-step approach:

   - Step 1: Identify the contract with the customer.
   - Step 2: Identify the separate performance obligations in the contract.
   - Step 3: Determine the transaction price.
   - Step 4: Allocate the transaction price to separate performance obligations.
   - Step 5: Recognise revenue when (or as) each performance obligation is satisfied.

> PwC observation:
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> The five steps might appear simple, but significant judgement will be needed to apply the underlying principles, and most entities should expect some level of change from current practice. A change of mindset about revenue recognition might be needed to migrate from an evaluation of risk and rewards under existing guidance to an evaluation of transfer of control under the new standard.

Step 1: Identify the contract with the customer

8. A contract is an agreement between two or more parties that creates enforceable rights and obligations and has commercial substance. It can be written, oral, or implied by an entity's customary business practice. A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities. An entity will need to apply the revenue standard to each contract with a customer unless the contracts are combined.

9. Contracts might involve financing provided by the seller where the borrower can put the collateral back to the seller in satisfaction of the loan (non-recourse seller financing). Management will need to determine whether a contract exists in these circumstances and whether the parties are committed to perform their obligations under the contract. Parties might not be committed to perform under the contract if payment terms reflect uncertainty about the customer's intent to comply with its obligations.

Contract combination

10. Contracts will be combined and accounted for as a single contract only if they are entered into at or near the same time, with the same customer (or related parties), and one or more of the following criteria are met:

    - The contracts are negotiated as a package with a single commercial objective.
    - The amount of consideration to be paid in one contract depends on the price or performance of the other contract.
    - The goods or services promised in the separate contracts are a single performance obligation.

11. Explicit and implicit promises in a contract to provide goods or services, including offers to provide goods or services that the customer can resell or provide to its customer (an 'end customer'), are performance obligations, even if they are satisfied by another party.

12. Entities that offer goods or services to an end customer that will be honored by a third party will need to allocate some of the transaction price to those goods or services.

Who's most affected?

Entities in the following sectors:

- *Automotive.*
- *Industrial products.*
- *Retail and consumer.*

They will then recognise revenue as those goods or services are delivered or performed. These promises are different from promises to pay cash to a customer. Promises to pay cash to a customer are not performance obligations, but are reductions of the transaction price unless paid for a distinct good or service.

13. The accounting for promises made at contract inception might differ from the accounting for promises made subsequently if those promises were not anticipated at contract inception. For example, an entity might offer goods or services to an end customer at the inception of a contract, but then modify or change that offer at a later date. Contract modification guidance should be applied to promises made after contract inception.

PwC observation:

Entities that offer incentives to their customers' customer might be significantly affected by this guidance depending on their current accounting practices. These entities might need to dedicate significant resources to developing or implementing systems, processes, and internal controls to ensure proper tracking and accounting for these offers since they might be additional performance obligations. Cash incentives offered to end customers will reduce the transaction price and will not impact the timing of revenue recognition.

Contract modifications

14. A contract modification is treated as a separate contract if it results in the addition of a separate performance obligation and the price reflects the stand-alone selling price of that performance obligation. Otherwise, a modification is accounted for as an adjustment to the original contract, either prospectively or through a cumulative catch-up adjustment.

15. An entity will account for a modification prospectively if the goods or services in the modification are distinct from those transferred before the modification. An entity will account for a modification through a cumulative catch-up adjustment if the goods or services in the modification are not distinct and are part of a single performance obligation that is only partially satisfied when the contract is modified.

16. A contract modification that only affects the transaction price will be treated like any other contract modification. The change in price will be either accounted for prospectively or on a cumulative catch-up basis, depending on whether the remaining performance obligations are distinct.

17. A contract modification is approved when the modification creates or changes the enforceable rights and obligations of the parties to the contract.

18. Management will need to determine if a modification, such as a claim or unpriced change order, is approved either in writing, orally, or implied by customary business practice such that it creates enforceable rights and obligations before recognising the related revenue.

Who's most affected?

Entities in the following sectors:

- *Aerospace and defence.*
- *Engineering and construction.*
- *Industrial products.*
- *Retail and consumer.*

PwC observation:

Management will need to apply judgement in evaluating whether goods or services in the modification are distinct to determine whether a contract modification should be accounted for prospectively or as a cumulative catch-up adjustment. This may be particularly challenging in situations where there are multiple performance obligations in a contract.

This assessment might also be difficult for contract claims, as no specific guidance has been provided for the accounting for contract claims. Management will have to evaluate contract claims similar to other contract modifications and apply judgement to determine when a claim is approved.

Step 2: Identify the separate performance obligations in the contract

19. A performance obligation is a promise (whether explicit, implicit, or implied by an entity's customary business practice) in a contract with a customer to transfer a good or service to the customer. Identifying the separate performance obligations in a contract is essential to applying the revenue recognition model. Separate performance obligations are the units of account to which the transaction price is allocated, and satisfaction of those separate performance obligations determines the timing of revenue recognition.

20. An entity will account for a promised good or service (or a bundle of goods or services) as a separate performance obligation only if both of the following criteria are met:

    - the promised good or service is capable of being distinct because the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; and
    - the promised good or service is distinct in the context of the contract because the good or service is not highly dependent on, or highly interrelated with, other promised goods or services in the contract.

21. Determining whether a good or service is 'distinct in the context of the contract' will require assessment of the contract terms and the intent of the contracting parties. Indicators of when a good or service is distinct in the context of a contract are:

    - The entity does not provide a significant service of integrating the goods or services into the bundle of goods or services that the customer has contracted for.
    - The customer is able to purchase or not purchase the good or service without significantly affecting the other promised goods or services in the contract.
    - The good or service does not significantly modify or customise another good or service promised in the contract.
    - The good or service is not part of a series of consecutively delivered goods or services promised in a contract that meet the following two conditions:
        - the promises to transfer those goods or services to the customer are performance obligations that are satisfied over time; and
        - the entity uses the same method for measuring progress to depict the transfer of those goods or services to the customer.

22. An entity will combine a good or service with other goods or services in the contract if they are not individually separable until a separate performance obligation is identified.

23. Entities that enter into contracts with customers to provide a series of promised goods or services delivered consecutively will need to

assess whether the contract is a single performance obligation or contains multiple separate performance obligations.

PwC observation:

The guidance allows management to apply judgement in determining separate performance obligations since it provides indicators rather than criteria. The use of indicators will help management assess when goods or services should be bundled or accounted for separately, and allow an approach that best reflects the economic substance of a transaction.

Step 3: Determine the transaction price

24. The transaction price is the amount of consideration that an entity expects to be entitled to in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of a third party (for example, sales taxes). Determining the transaction price can be straightforward in many arrangements, but might be more complex if the arrangement involves variable consideration or a significant financing component.

Variable consideration and the constraint on revenue recognition

25. The transaction price might include an element of consideration that is variable or contingent upon the outcome of future events, including (but not limited to) discounts, rebates, refunds, credits, incentives, performance bonuses, and royalties. Revenue from variable consideration is only recognised when an entity has relevant experience with similar performance obligations.

26. The objective of the constraint is that an entity should recognise revenue as performance obligations are satisfied only up to an amount that is not subject to significant reversals in the future. This is intended to be a qualitative assessment as opposed to a specific quantitative confidence threshold. An entity will meet this objective if:

- it has relevant experience with similar types of performance obligations (or other valid evidence) that allows it to estimate the cumulative amount of revenue for a satisfied performance obligation; and
- based on that experience, it does not expect a significant reversal in future periods in the cumulative amount of revenue recognised for that performance obligation.

27. Management will need to apply judgement to assess whether it has relevant experience. The following indicators might suggest the entity's experience is not relevant:

- The amount of consideration is highly susceptible to factors outside the influence of the entity.
- The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- The entity's experience with similar types of contracts is limited.
- The contract has a large number and broad range of possible consideration amounts.

28. Factors outside the influence of the entity could include actions of third parties, such as sales by an entity's customers. However, the standard will not include specific guidance for recognising royalties earned based on a customer's subsequent sales. Therefore, it is possible that revenue might be recognised in advance of the actual sales made by the customer that trigger the royalty payments if the entity has sufficient relevant experience.

29. The recognition constraint not only applies to contracts with a variable price, but also to contracts with a fixed price if it is uncertain whether the entity will be entitled to all of the consideration even after the performance obligation is satisfied. One example is an entity that enters into a contract with a customer to provide legal services. The entity will only be paid its fee if the court rules in favour of the customer, and such a ruling is uncertain. The entity might not be able to recognise revenue until the court rules on the case, even though the legal services have been provided.

30. Performance-based incentive fees (for example, fees that vary based on the achievement of a contract milestone or an investment's performance) are also variable consideration and therefore, subject to the constraint.

Who's most affected?

Entities in the following sectors:

- *Aerospace and defence.*
- *Asset management.*
- *Engineering and construction.*
- *Entertainment and media.*
- *Pharmaceutical and life sciences.*
- *Technology.*

PwC observation:

Some entities will recognise revenue before all contingencies are resolved under this guidance, which might be earlier than current practice, if they have relevant experience about the amount of consideration to which they will be entitled. There might be situations where management does not have relevant experience for the entire transaction price, but does have relevant experience up to a certain amount, or a 'floor.' The 'floor' amount might be used to determine the transaction price in this situation. Management might need to put into place new processes to estimate these amounts and monitor estimates on an ongoing basis as more experience is obtained.

Entities that defer revenue recognition under current guidance because the price is not fixed or determinable (US GAAP) or measured reliably (IFRS) might be significantly affected by the new standard. An example is a situation where the price is fixed, but the entity has a history of granting concessions. Entities could be required to recognise the minimum amount of revenue they expect to be entitled to when control transfers.

Entities that currently license intellectual property and recognise royalty revenue when subsequent sales occur might need to recognise revenue earlier under the new standard. An entity that has sold a right will need to recognise revenue at the time of transfer of the licence if it has relevant experience about the outcome of the arrangement (see additional discussion in the 'Licences' section below). Judgement will be needed to determine whether the entity's experience is relevant.

Time value of money

31. The transaction price should be adjusted for the effects of time value of money when the contract contains a significant financing component. A practical expedient allows entities to disregard the time value of money if the period between transfer of the goods or services and payment is less than one year even if the contract itself is for more than one year. Examples will be provided to illustrate when an arrangement includes a significant financing component, but management should consider the following factors, among others:

    - the length of time between when the entity transfers the goods or services to the customer and when the customer pays for them;
    - whether the amount of consideration would substantially differ if the customer paid cash when the goods or services were transferred; and
    - the interest rate in the contract and prevailing interest rates in the relevant market.

32. An entity that is paid in advance for goods or services need not reflect the effects of the time value of money when the timing of transfer of those goods or services is at the customer's discretion. An example is an arrangement where a customer purchases a prepaid phone card from a telecom entity and uses the prepaid airtime at his or her

discretion. Another example is a customer loyalty program where the customer can redeem the points awarded by the entity at his or her discretion. Those entities will not be required to account for time value of money even though there could be a significant timing difference between payment and performance.

33. Interest income will need to be presented separately from revenue from the sale of goods or services. An entity will not be precluded from presenting interest income as a type of revenue if it generates interest income in the ordinary course of business, similar to a financial services entity.

PwC observation:

It might be difficult to determine whether a significant financing component exists in a contract, especially long-term arrangements or multiple-element arrangements because goods or services might be delivered and cash payments received throughout the arrangement.

For example, a software entity agrees to provide three years of post-contract customer support (PCS) for $300, which the customer pays up-front and can renew for $100 annually. The entity will need to consider whether there is a significant financing component because the customer paid the $300 in advance, but there is no difference in the annual pricing ($100 per year initially and for annual renewals).

Another example is a construction entity that enters into a four-year arrangement for services that are provided over the contract term. A specified percentage of the amounts owed are withheld by the customer throughout the arrangement until completion evidenced by acceptance. The entity will need to consider whether there is a significant financing component since a portion of the payment is not received until the end of the contract.

An entity with contracts that include a significant financing component might need to consider the operational challenge of measuring and tracking that element of the arrangement, as well as the need for additional information technology systems, processes, and internal controls, and plan accordingly.

Noncash consideration

34. An entity will measure any noncash consideration received at its fair value to determine the transaction price. An entity will measure the promised consideration indirectly by reference to the selling price of the goods or services promised in the arrangement if it cannot reasonably estimate the fair value of the consideration received.

35. An entity might have a customer that contributes goods or services (for example, materials, equipment, or labour) to facilitate the fulfillment of a contract. The entity will need to assess whether it obtains control of those contributed goods or services. The entity will account for the contributed goods or services as noncash consideration received from the customer if it obtains control of those goods or services.

Consideration payable to a customer

36. Consideration paid (or expected to be paid) to a customer (or to a customer's customer) will reduce the transaction price. An entity will recognise the reduction of revenue when the later of the following occurs:

- the entity recognises revenue for the transfer of the promised goods or services to the customer; or
- the entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practice.

Step 4: Allocate the transaction price to separate performance obligations

37. After an entity identifies the separate performance obligations and determines the transaction price, the transaction price is allocated to the separate performance obligations in the arrangement.

38. The transaction price will be allocated to separate performance obligations based on the relative stand-alone selling prices of the goods or services promised. The best evidence of stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately. Management will need to estimate the selling price if a stand-alone selling price is not available, and should maximise the use of observable inputs. Possible estimation methods include (but are not limited to):

   - expected cost plus reasonable margin;
   - assessment of market prices for similar goods or services; and
   - residual approach, in certain circumstances.

39. A residual approach may be used to calculate the stand-alone selling price when the selling price is highly variable or uncertain for one or more goods or services, regardless of whether that good or service is delivered at the beginning or at the end of the contract.

40. A selling price is highly variable when an entity sells the same good or service to different customers (at or near the same time) for a broad range of prices. A selling price is uncertain when an entity has not yet established a price for a good or service or the good or service has not been sold previously.

41. Discounts or variable consideration should first be allocated to one or more specific performance obligation(s) if the criteria in paragraphs 42 and 43 are met. The entity can then use the residual approach to estimate the stand-alone selling price of any other performance obligations if the stand-alone selling prices are highly variable or uncertain.

42. An entity should allocate a discount entirely to one or more separate performance obligation(s) in the contract if the price of a good or service is largely independent of the price of other goods or services in the arrangement based on the following criteria:

   - the entity regularly sells each good or service in the contract separately; and
   - the observable selling prices from those sales provide evidence of the performance obligation to which the discount in the contract belongs.

43. Variable consideration, including subsequent changes to the amount, and changes to the transaction price might affect one (or more) performance obligation(s). Such changes will be allocated to that performance obligation rather than all performance obligations in the arrangement if the following criteria are met:

   - The contingent payment terms relate to a specific performance obligation or outcome from satisfying that performance obligation.
   - Allocating the contingent amount of consideration entirely to the separate performance obligation is consistent with the amount of consideration that the entity expects to be entitled to for that performance obligation.

Who's most affected?

Entities in the following sectors:

- *Software.*
- *Telecommunications.*

PwC observation:

The residual approach is different from the residual method that is used by some entities today (for example, software companies). Applying today's residual method results in the entire discount in an arrangement being allocated to the delivered item.

The residual approach in the new guidance should be used to estimate the stand-alone selling price of the separate good or service, not to determine the amount of consideration allocated to a specific performance obligation. This approach requires that any discounts related to specific performance obligations first be allocated to those performance obligations prior to using the residual approach to determine the stand-alone selling price of the remaining item(s). This could result in a change for some entities, requiring new processes be put into place to estimate these amounts.

Use of the residual approach should be limited. Those who estimate a selling price today should not expect to revert to a residual approach under the new standard.

Step 5: Recognise revenue when (or as) each performance obligation is satisfied

44. The final step in the model is recognising revenue. An entity will recognise revenue when (or as) a good or service is transferred to the customer and the customer obtains control of that good or service. Control of an asset refers to an entity's ability to direct the use of and obtain substantially all of the remaining benefits from the asset.

Who's most affected?

Entities in the following sectors:

- *Aerospace and defence.*
- *Consumer and industrial products.*
- *Engineering and construction.*
- *Entertainment and media.*
- *Technology.*

PwC observation:

The standard requires management to determine when control of the goods has transferred to the customer. The timing of revenue recognition could change for some entities compared to current guidance, which is more focused on the transfer of risks and rewards than the transfer of control. The transfer of risks and rewards is an indicator of whether control has transferred under the new standard, but additional indicators will also need to be considered.

Performance obligations satisfied over time or at a point in time

45. Performance obligations can be satisfied either over time or at a point in time. An entity will recognise revenue over time if any of the following criteria are met:

- The customer receives and consumes the benefits of the entity's performance as the entity performs.
- The entity's performance creates or enhances an asset (work-in-progress) that the customer controls as the asset is created or enhanced.
- The entity's performance does not create an asset with an alternative use to the entity and the customer does not have control over the asset created, but the entity has a right to payment for performance completed to date.

46. The first criterion generally addresses service contracts where no asset is created and the customer consumes the services as they are provided. Management should assess if another entity would need to substantially reperform the work completed to date to fulfill the remaining obligation to the customer. Contractual or practical limitations that prevent an entity from transferring a remaining performance obligation to another entity are not considered in this evaluation.

47. The second criterion addresses transactions where an asset is created and the customer controls that asset as it is created. This applies in situations where the customer controls the work-in-progress as the entity manufactures goods. Management should apply the guidance on transfer of control to determine whether the customer obtains control of the asset as it is created.

48. The last criterion addresses situations where the customer does

not control an asset as it is created or transfer of control is not apparent. Management will need to consider whether the asset being created has an alternative use to the entity and whether the entity has a right to payment for performance to date.

49. The assessment of whether an asset has an alternative use should be made at the inception of the contract. Management should consider its ability to redirect a product that is partially completed to another customer, considering both contractual and practical limitations. A substantive contractual restriction that limits management's ability to redirect the asset could indicate the asset has no alternative use. Practical limitations, such as significant costs required to rework the asset so it could be directed to another customer, could also indicate that asset has no alternative use.

50. To conclude it has a right to payment, an entity must be entitled to payment for performance completed to date even if the customer can terminate the contract for reasons other than the entity's non-performance. A specified payment schedule does not by itself indicate the entity has a right to payment for performance to date. The assessment of the enforceability of the right to payment should include consideration of the contract terms and any legal restrictions or requirements that could override the contract terms.

51. The right to payment should compensate the entity at an amount that reflects the selling price of the goods or services provided to date. For example, this might be an amount that covers an entity's cost plus a reasonable profit margin for work completed.

52. An entity will recognise revenue at a point in time (when control transfers) if performance obligations in a contract do not meet the criteria for recognition of revenue over time.

53. Indicators that the customer has obtained control of goods or services include:

- The entity has a right to payment for the asset.
- The entity transferred legal title to the asset.
- The entity transferred physical possession of the asset.
- The customer has the significant risk and rewards of ownership.
- The customer has accepted the asset.

PwC observation:

Management will need to apply judgement to assess the criteria for performance obligations satisfied over time, especially when assessing whether assets have an alternative use and whether the entity has a right to payment for performance completed to date. For example, management will need to assess whether there is a substantive reason for restrictions on transfer of the asset(s) to another party in a contract to determine whether assets have an alternative use.

Entities that sell highly customised products that can only be used by a single customer and entities that are the only provider of products for a specific customer might conclude that the products they create do not have an alternative use. These entities will recognise revenue over time if they have the right to payment as products are manufactured. This might result in recognising revenue earlier than current practice (that is, as the units are produced, rather than when they are delivered).

Measuring progress toward satisfying a performance obligation

54. For a performance obligation satisfied over time, the objective is to recognise revenue in a manner that depicts the transfer of control of the promised goods or services to the customer. Methods for measuring progress include:

    - Output methods that recognise revenue based on units produced or delivered, contract milestones, or surveys of work performed.

    - Input methods that recognise revenue based on costs incurred, labour hours expended, time lapsed, or machine hours used.

55. There might be uninstalled materials that a customer controls prior to the performance of the services related to those goods. This can create challenges if an entity is using an input method to measure progress. This measure should be adjusted to ensure that the measure of progress used depicts the entity's performance.

56. Example(s) will be provided in the final standard to illustrate that measures of progress of goods or services should include only those that depict transfer to the customer.

57. Manufacturers of large volumes of homogeneous goods that meet the requirements for performance obligations satisfied over time (see paragraph 45 above) will need to assess what measure of progress depicts the transfer of goods or services to the customer. Transfer might not be upon delivery of the product in some situations.

58. An exception will not be provided to allow for the use of a 'units delivered' measure when a vendor manufactures large volumes of homogeneous goods, but also meets the requirements for performance obligations satisfied over time, when work-in-progress is material. Such an exception would circumvent the guidance on when performance obligations are satisfied over time.

Who's most affected?

Entities in the contract manufacturing sector

PwC observation:

Manufacturers of large volumes of homogeneous goods produced to a customer's specification might be surprised to find that they could meet the criteria for performance obligations satisfied over time. This is because (1) such goods often have no alternative use to the entity given their customisation, and (2) the payment terms in these arrangements might include a protective clause that provides for payment for performance to date in the event the contract is cancelled.

An example is a contract manufacturer that manufactures customised goods with no alternative use. The manufacturer might meet the criteria to recognise revenue over time if the customer will reimburse it for costs incurred plus a reasonable profit margin for both completed units and those in production at any point of time.

Entities that manufacture these types of goods could be required to recognise revenue as the goods are produced, rather than when they are delivered to the customer. Different outcomes for economically similar arrangements could result from this guidance. Slight differences in payment terms could result in the goods being treated as a performance obligation satisfied over time in one case and as inventory in another. The 'right to payment' criterion might not be satisfied if the customer only provides reimbursement for the cost of units in production. Revenue would be recognised when control transfers to the customer upon delivery in that case.

Other issues

59. Several issues exist beyond applying the five steps of the model. The standard provides guidance in the following areas to assist entities in applying the model.

Who's most affected?

Entities in the following sectors:

- *Entertainment and media.*
- *Franchisors.*
- *Pharmaceutical and life sciences.*
- *Technology.*

Licences

60. A licence is the right to use an entity's intellectual property including, among others: software and technology; media and entertainment rights; franchises; patents; trademarks; and copyrights. Given the diversity in the types of licences granted, there is not a 'one size fits all' approach to accounting for licences. In some cases, a licence is a promise to provide a right, which transfers to the customer at a point in time. In other cases, a licence is a promise to provide access to an entity's intellectual property, which transfers benefits to the customer over time.

61. Management should consider the characteristics of the licence and the commercial substance of the agreement to determine whether the licence reflects a right transferred at a point in time. A right that might be viewed similar to a tangible good, or an arrangement that allows the customer to determine how and when to use the right without assistance from the licensor, might indicate that a right transfers at a point in time.

62. A licence might represent a promise to provide access to an entity's intellectual property when the above or similar characteristics are not present. Further guidance is expected in the final standard to help determine whether a licence transfers a right or provides access.

PwC observation:

Accounting for licences remains the topic of much debate. The fact that licences come in a variety of forms and are common in a number of industries makes it challenging to develop a single, principles-based model.

Once other aspects of the model are applied, it might not be necessary to assess the nature of a licence to determine the appropriate accounting treatment. For example, licences for intellectual property might not be separable from other goods or services in an arrangement. A licence that does not qualify as a separate performance obligation will be recognised when or as the other performance obligations in the arrangement are satisfied. Variable consideration from a licence will only be recognised as revenue when the constraint on variable consideration is overcome.

The boards are continuing to develop indicators that an entity will use to determine whether a licence is a promise to provide a right or a promise to provide access to an entity's intellectual property. Factors that indicate the licence is a promise to provide access to the licensor's intellectual property might include, but are not limited to:

- the licensor has continuing obligations under the arrangement that do not otherwise qualify as separate performance obligations (such as sponsorship arrangements); or
- the licensor must actively make the intellectual property available to the licensee on a continuous basis during the licence period.

It will be important to review the indicators that the boards ultimately agree on to determine whether a licence represents a right or merely provides access to intellectual property over time. This assessment could require significant judgement in many instances.

Contract costs

63. An entity will recognise an asset for the incremental costs to obtain a contract if management expects to recover those costs. Incremental costs of obtaining a contract are costs the entity would not have incurred if the contract had not been obtained (for example, sales commissions). An entity can expense the cost of obtaining a contract if the amortisation period would be less than one year.

64. An entity will recognise an asset for costs to fulfill a contract if they generate or enhance a resource that the entity will use to satisfy future

performance obligations, and the costs are expected to be recovered. Management will need to consider whether costs to fulfill a contract should be accounted for in accordance with other standards (for example, inventory, fixed assets, or intangible assets) before applying the guidance in the revenue standard.

65. An asset recognised for the costs to obtain or fulfill a contract will be amortised on a systematic basis as the goods or services to which the assets relate are transferred to the customer.

Who's most affected?

Entities in the following sectors:

- *Aerospace and defence.*
- *Engineering and construction.*
- *Financial institutions.*
- *Technology.*
- *Telecommunications.*

PwC observation:

This guidance will likely result in the recognition of more assets than current guidance would permit. Entities that expense sales commissions as paid and set-up costs as incurred could now be required to capitalise and amortise these costs if the costs are recoverable. These entities will need to develop processes to track the related costs and perform periodic impairment assessments to determine if the assets remain recoverable. It is unclear how contract costs that were previously expensed but would be capitalised under the revenue standard will be treated at transition.

Collectibility

Who's most affected?

Any entity that defers revenue on sales to high credit risk customers

66. Collectibility refers to a customer's credit risk. It is the risk that an entity will be unable to collect from the customer the amount of consideration that the entity is entitled to under the contract.

67. Initial and subsequent impairment of customer receivables, to the extent material, will be presented separately below gross margin as an expense. This expense must be presented on the face of the income statement if it is material.

PwC observation:

Collectibility will no longer be a recognition threshold, so revenue might be recognised earlier by entities that currently defer recognition of revenue due to collectability concerns. This is a significant change for both IFRS and US GAAP, as both currently have a collectibility threshold for revenue recognition. Management will need to estimate the amount of revenue they do not expect to collect and record an expense when the transaction occurs.

Repurchase agreements

Who's most affected?

Entities in the following sectors:

- *Automative.*
- *Heavy industrial products.*

68. An entity that has an obligation or right to repurchase an asset (a forward or a call option) has not transferred control of the asset to the buyer if the forward or call is substantive. An entity will account for the transaction as a lease if the repurchase price is less than the original sales price or as a financing if the repurchase price is equal to or greater than the original sales price of the asset.

69. An arrangement where a customer has the right to require that an entity repurchase an asset (a put option) at a repurchase price less than the original sales price will be accounted for as a lease if the arrangement provides the customer a significant economic incentive to exercise that right. The arrangement is a financing if the repurchase price of the asset exceeds the original sales price and is more than the expected market value of the asset.

70. Sale-leaseback transactions that include a put option with a repurchase price less than the original sales price and for which the customer has a significant economic incentive to exercise will be accounted for as a financing.

71. A residual value guarantee provided by a seller will not necessarily preclude revenue recognition, but could affect the transaction price. An entity that has an explicit or implicit obligation to repurchase the asset should account for such an obligation as a put option.

Principal versus agent

72. Entities often involve third parties when providing goods and services to their customers. Management needs to assess whether the entity is acting as the principal or an agent in such arrangements. An entity recognises revenue on a gross basis if it is the principal in the arrangement, and on a net basis (that is, equal to the commission received) if it is acting as an agent.

73. An entity is the principal in an arrangement if it obtains control of the goods or services of another party in advance of transferring control of those goods or services to a customer. The entity is an agent if its performance obligation is to arrange for another party to provide the goods or services.

74. Indicators that the entity is an agent include:

    - The other party has primary responsibility for fulfillment of the contract (that is, the other party is the primary obligor).
    - The entity does not have inventory risk.
    - The entity does not have latitude in establishing prices.
    - The entity does not have customer credit risk.
    - The entity's consideration is in the form of a commission.

PwC observation:

The indicators in the revenue standard are similar to the current guidance in IFRS and US GAAP. The guidance does not weigh any of the indicators more heavily than others, unlike existing US GAAP. However, we do not expect a significant change in practice with regard to principal versus agent assessments for most industries. New and evolving business models, especially related to internet transactions, have resulted in an increased focus in this area.

Options to acquire additional goods or services

75. An entity might grant a customer the option to acquire additional goods or services free of charge or at a discount. These options might include customer award credits or other sales incentives and discounts. That promise gives rise to a separate performance obligation if the option provides a material right to the customer that the customer would not receive without entering into the contract. The entity will recognise revenue allocated to the option when the option expires or when the additional goods or services are transferred to the customer.

76. An example of a material right is a discount that is incremental to the range of discounts typically given to similar customers in the same market. The customer is effectively paying in advance for future goods or services and therefore revenue is recognised when those future goods or services are transferred or when the option expires.

77. An option to acquire an additional good or service at a price that is within the range of prices typically charged for those goods or services does not provide a material right to the customer and is a marketing offer. This is the case even if the option can be exercised only because the customer entered into the previous contract.

78. The estimate of a stand-alone selling price for a customer's option to acquire additional goods or services is the discount the customer expects to obtain when exercising the option. This estimate is adjusted for any discount the customer would receive without exercising the option and the likelihood that the customer will exercise the option (that is, breakage or forfeiture).

79. For example, an entity that grants customer loyalty points on current purchases that can be redeemed against future purchases will need to estimate the stand-alone selling price of the points, adjusted for breakage. Revenue allocated to these points will be recognised when the points are redeemed or expire if the points provide a material right to the customer. The entity will also need to consider whether it is acting as a principal or an agent for the goods or services provided upon redemption of the points. An entity acting as an agent will recognise only its commission as revenue when the points are transferred to a third party.

Rights of return

80. An entity will account for the sale of goods with a right of return by recognising revenue for the consideration it expects to retain (considering the products expected to be returned) and a liability for the refund it expects to pay to customers. Both are updated for changes in expected refunds each reporting period.

81. The entity will also recognise an asset and corresponding adjustment to cost of sales for the right to recover goods from customers. The asset is initially measured at the original cost of the goods less any expected costs to recover those goods. Impairment is assessed at each reporting date.

Warranties

82. An entity accounts for a warranty as a separate performance obligation if the customer has the option to purchase the warranty separately. An entity accounts for a warranty as a cost accrual if it is not sold separately unless the warranty is to provide the customer with a distinct service.

83. A warranty might provide a customer with a service (that, a service-based warranty) in addition to the assurance that the product complies with agreed specifications (that is, quality assurance). The service is accounted for as a separate performance obligation in those situations. An entity that promises both a quality assurance and service-based warranty, but cannot reasonably separate the obligations and account for them separately, should account for both warranties together as a separate performance obligation.

Who's most affected?

Entities that provide multi-year warranties, such as those in the automotive sector

PwC observation:

The guidance on accounting for warranties is generally consistent with current guidance under IFRS and US GAAP. However, it might be difficult to separate a single warranty that provides both a standard warranty and a service in some arrangements. Management will have to develop processes to estimate stand-alone selling prices and to allocate the transaction price between the performance obligations in the arrangement when such services are not sold separately.

Nonrefundable upfront fees

84. Some entities charge a customer a nonrefundable fee at the beginning of an arrangement. Examples might include set-up fees, activation fees, or membership fees. Management needs to determine whether a nonrefundable upfront fee relates to the transfer of a promised good or service to a customer.

85. A nonrefundable upfront fee might relate to an activity undertaken at or near contract inception (for example, customer set-up activities), but that does not indicate satisfaction of a separate performance obligation if the activity does not result in the transfer of a

promised good or service to the customer. The upfront fee is recognised as revenue when goods or services are provided to the customer in the future.

86. If the nonrefundable upfront fee relates to a performance obligation, management needs to assess whether that performance obligation is distinct from other performance obligations in the contract.

Bill-and-hold arrangements

87. In a bill-and-hold arrangement, an entity bills a customer for a product but does not ship the product until a later date. Revenue is recognised on transfer of control of the goods to the customer. All of the following requirements must be met to conclude that the customer has obtained control in a bill-and-hold arrangement:

- the reason for the bill-and-hold arrangement must be substantive;
- the product must be identified separately as the customer's product;
- the product must be ready for delivery at the time and location specified by the customer; and
- the entity cannot have the ability to sell the product to another customer.

88. Management also needs to consider whether the custodial services of storing the goods are a material separate performance obligation to which some of the transaction price should be allocated.

PwC observation:

The list of indicators provided for bill-and-hold transactions is generally consistent with the current guidance under IFRS. There may be situations where revenue is recognised earlier compared to current US GAAP for bill-and-hold arrangements because there is no longer a requirement for the vendor to have a fixed delivery schedule from the customer in order to recognise revenue.

Transfers of assets that are not an output of an entity's ordinary activities

89. An entity will need to apply the control transfer and measurement requirements of the revenue standard (including the constraint on revenue recognised) to sales of nonfinancial assets that are not an output of the entity's ordinary activities. This guidance will need to be applied to determine when the asset should be derecognised and determine the consideration to be included in the net gain or loss recognised on transfer of these assets.

Consignment arrangements

Who's most affected?

Entities in the retail and consumer sector

90. Certain industries transfer goods to dealers or distributors on a consignment basis. The transferor typically owns the inventory on consignment until a specified event occurs, such as the sale of the product to a customer of the distributor, or until a specified period expires.

91. To determine whether revenue should be recognised upon transfer of goods to the distributor or upon ultimate sale to an end customer, management should consider whether:

- the distributor has an unconditional obligation to pay for the goods; and
- the entity can require return of the product or transfer to another distributor (which indicates that control has not transferred to the distributor).

Onerous performance obligations

92. New guidance will not be provided on the accounting for onerous performance obligations. The FASB will instead carry forward existing US GAAP guidance, which includes the onerous loss guidance in ASC 605-35, 'Construction-type and

production-type contracts', and other industry-specific guidance. The guidance carried forward will be limited to those contracts currently in the scope of that guidance. The IASB decided that contracts with customers will be subject to the onerous contract provisions in IAS 37, 'Provisions, contingent liabilities and contingent assets'.

Who's most affected?

Entities in the following sectors:

- *Aerospace and defence.*
- *Engineering and construction.*
- *Technology.*

PwC observation:

The boards will need to ensure the scope of the retained guidance is clear if they are to capture all contracts currently subject to such guidance. The IASB will also need to consider whether to carry forward the loss-making contracts guidance in IAS 11, 'Construction contracts'.

Disclosures

93. The revenue standard includes a number of disclosure requirements intended to enable users of financial statements to understand the amount, timing, and judgements related to revenue recognition and corresponding cash flows. The disclosures will include qualitative and quantitative information about contracts with customers.

94. The FASB and IASB agreed on annual disclosures but diverged on interim disclosure requirements. The tentative decisions about disclosure requirements are summarised below.

Disclosure type	Disclosure requirements
Disaggregation of revenue	Disclose disaggregated revenue information in categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. Reconcile disaggregated revenue to revenue for reportable segments.
Reconciliation of contract balances	Disclose opening and closing balances of contract assets (such as unbilled receivables) and liabilities (such as deferred revenue) and provide a qualitative description of significant changes in these amounts. Disclose the amount of revenue recognised in the current period relating to performance obligations satisfied in a prior period (such as from contracts with variable consideration). Disclose the opening and closing balances of trade receivables if not presented elsewhere.
Remaining performance obligations	Disclose the amount of the transaction price allocated to any remaining performance obligations not subject to significant revenue reversal. Provide a narrative discussion of potential additional revenue in constrained arrangements.
Costs to obtain or fulfill contracts	Disclose the closing balances of capitalised costs to obtain and fulfill a contract and the amount of amortisation in the period. Disclose the method used to determine amortisation for each reporting period.
Other qualitative disclosures	Disclose significant judgements and changes in judgements that affect the amount and timing of revenue from contracts with customers. Disclose how management determines the minimum amount of revenue not subject to the variable consideration constraint. Describe the practical expedients, including those for transition, used in an entity's revenue accounting policies.
Interim period disclosures	Retain current interim disclosure requirements under the existing standards. Disclose disaggregation of revenue, contract balances, and remaining performance obligation disclosures (FASB-only). Disclose disaggregation of revenue (IASB-only).

PwC observation:

The disclosure requirements are significantly greater than existing disclosure requirements for revenue under IFRS and US GAAP. The revenue standard could add significant disclosures for interim financial statements as well. This could result in management needing to put systems, processes, and internal controls in place to capture information that has historically not been needed for financial reporting purposes, particularly in interim financial statements.

It is expected that the FASB will discuss the disclosure requirements for US nonpublic entities at a future meeting to decide whether those entities should be allowed certain disclosure reliefs.

Transition and effective date

95. Entities will apply the revenue standard in the first interim period within annual reporting periods beginning on or after 1 January 2017 (for example, 1 January 2017 for an entity with a 31 December 2017 year-end). Earlier adoption will not be permitted under either IFRS or US GAAP, except perhaps under IFRS for entities adopting IFRS for the first time, which will be discussed at a future IASB-only meeting. The effective date for US nonpublic entities is expected to be discussed at a future FASB-only meeting.

96. An entity can apply the new revenue standard retrospectively, including using certain practical expedients such as not restating contracts that begin and end in the same period and using hindsight in accounting for variable consideration in completed contracts.

97. An entity can also choose to use the following method to simplify transition:

    - Apply the revenue standard to all existing contracts as of the effective date and to contracts entered into subsequently.
    - Recognise the cumulative effect of applying the new standard to existing contracts in the opening balance of retained earnings on the effective date.
    - In the year the standard is initially adopted, provide the following additional disclosures, beginning with the first interim period:
        - the amount by which each financial statement line item is affected in the current year as a result of the entity applying the new revenue standard; and
        - an explanation of the significant changes between the reported results under the new revenue standard and legacy guidance.

98. An entity that uses this simplified transition method must disclose this fact in its financial statements.

PwC observation:

The availability of this new simplified transition method should significantly reduce transition issues for preparers that choose this option. The requirement to disclose how all of the financial statement line items in the current year have been affected as a result of applying the revenue standard will allow for comparability in the year of adoption and provides trend information, a key concern of investors. This footnote will also be required in interim financial statements.

The longer than normal period of time from finalisation of the standard to the effective date is provided because of the pervasiveness of the standard and the importance of reporting revenue. It is intended to ensure there is sufficient time for entities that want to use full retrospective application as well as for those that use the simplified transition method, given the concerns of preparers about the amount of effort adopting the standard might require. Full retrospective application provides more holistic trend information that some entities might prefer to provide to investors, so it was important to provide sufficient time for these preparers to transition.

Next steps

The boards are targeting to issue the final standard in the second quarter of 2013.

Questions

PwC clients who have questions about this practical guide should contact their engagement partner.

Appendix

Redeliberation decisions to date

The table below summarises the decisions reached by the boards to date. These decisions are tentative and subject to change until a final standard is issued.

Topic	November 2011 exposure draft	Tentative decision
Scope	An entity will apply the proposed revenue standard to all contracts with customers (excluding specific contracts like leasing, insurance, financial instruments, etc.). A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities. An entity shall apply this proposed guidance to a contract only if the counterparty to the contract is a customer. For some contracts, the counterparty to the contract might not be a customer but rather a collaborator or a partner that shares with the entity the risks and benefits of developing a product to be marketed. Such contracts are not in the scope of this proposed guidance.	The boards confirmed that the revenue recognition standard will apply to all contracts with customers, including transactions with collaborators or partners if they are in substance a customer in the transaction.
Identifying the contract	A contract exists if all of the following criteria are met: • the contract has commercial substance; • the parties to the contract have approved the contract and are committed to perform their respective obligations; • management can identify each party's rights and obligations regarding the goods or services to be transferred; and • management can identify the terms and manner of payment for the goods or services to be transferred.	The boards decided to include indicators of when parties to the contract are committed to perform their respective obligations. Some of the indicators being considered are: • whether payment terms reflect uncertainty about the customer's intent; • the reasons for entering into the contract in light of the parties' business models; and • experience or lack of thereof with the customer for similar transactions.
Contract combinations for distributor and reseller arrangements	An entity might need to combine two or more contracts entered into at or near the same time with the same customer if one or more of the following criteria are met: • the contracts are negotiated as a package with a single commercial objective; • the amount of consideration to be paid in one contract depends on the price or performance of the other contract; and • the goods or services promised in the separate contracts are a single performance obligation.	The boards retained the existing combination guidance. They also clarified that all promises to provide goods or services, including offers to provide goods or services that the customer can resell or provide to its customer, are performance obligations even if they are satisfied by another party. These promises are different from promises to pay cash to the customer, which are accounted for as reductions of the transaction price, unless paid for a distinct good or service.

Topic	November 2011 exposure draft	Tentative decision
Contract modifications	A contract modification is treated as a separate contract only if it results in the addition of a distinct performance obligation and the price is reflective of the stand-alone selling price of that additional performance obligation. The modification is otherwise accounted for as an adjustment to the original contract, either through a cumulative catch-up adjustment to revenue or a prospective adjustment to revenue when future performance obligations are satisfied, depending on the facts and circumstances.	The boards retained the proposed guidance for contract modifications. They clarified that a contract modification, including a contract claim, is approved when the modification creates or changes the enforceable rights and obligations of the parties to the contract, which could be in writing, oral, or implied by customary business practice. The boards will consider including an example that addresses modifications due to contract claims and/or unpriced change orders. The boards clarified that the accounting for a contract modification that only affects the transaction price should be treated like any other contract modification. The change in price will be accounted for either prospectively or on a cumulative catch up basis, depending on whether the remaining performance obligations are distinct.

1. Identify the contract(s) with the customer
2. Identify and separate performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognise revenue when a performance obligation is satisfied

<table>
<tr><th>Topic</th><th>November 2011 exposure draft</th><th>Tentative decision</th></tr>
<tr>
<td>Identifying separate performance obligations</td>
<td>A separate performance obligation exists if the goods or services are ‘distinct.’ Goods or services are ‘distinct’ 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.

A bundle of goods or services is accounted for together as one performance obligation if both of the following criteria are met:

the goods and services are highly interrelated and the entity provides a significant service of integrating goods and services into the combined item that the customer has contracted for; and
the entity is contracted by the customer to significantly modify or customise the goods or services.

</td>
<td>The boards decided that an entity should account for a promised good or service (or a bundle of goods or services) as a separate performance obligation only if both of the following criteria are met:

the promised good or service is capable of being distinct because the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; and
the promised good or service is distinct within the context of the contract because the good or service is not highly dependent on, or highly interrelated with, other promised goods or services in the contract.

The boards agreed that the assessment of whether a promised good or service is distinct in the context of the contract should be supported by indicators, such as:

The entity does not provide a significant service of integrating the goods or services.
The customer was able to purchase or not purchase the good or service without significantly affecting the other promised goods or services in the contract.
The good or service does not significantly modify or customise another good or service promised in the contract.
The good or service is not part of a series of consecutively delivered goods or services promised in a contract that meets the following two conditions:

the promises to transfer those goods or services to the customer are performance obligations that are satisfied over time; and
the entity uses the same method for measuring progress to depict the transfer of those goods or services to the customer.

The boards decided to remove the practical expedient that permitted an entity to account for two or more distinct goods or services as a single performance obligation if those goods or services have the same pattern of transfer to the customer.
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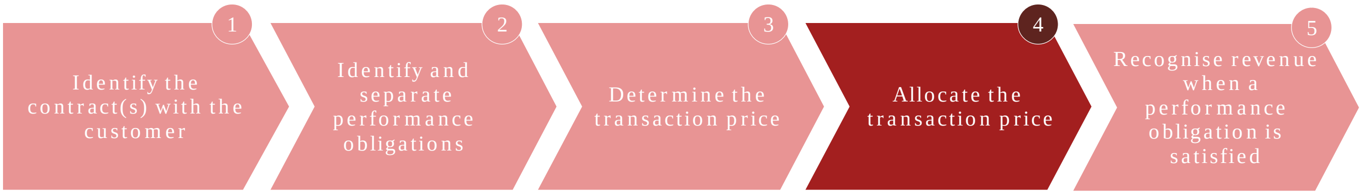
Topic	November 2011 exposure draft	Tentative decision
Constraint on revenue recognition	Revenue is recognised when a performance obligation is satisfied and the entity is 'reasonably assured' to be entitled to the transaction price allocated to that performance obligation. An entity is reasonably assured to be entitled to variable consideration if both of the following criteria are met: • the entity has experience with similar types of performance obligations; and • the entity's experience is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations For licences to use intellectual property in exchange for royalties based on the customer's subsequent sales of a good or service, the related variable consideration only becomes reasonably assured once those future sales occur.	The boards provided an objective of the constraint. An entity should recognise revenue as performance obligations are satisfied only up to an amount that should not be subject to significant reversals in the future. An entity should assess its experience with similar types of performance obligations and determine whether, based on that experience, the entity does not expect a significant reversal in future periods in the cumulative amount of revenue recognised. The boards decided to apply the constraint to the measurement of the transaction price, as originally proposed in the June 2010 exposure draft. This will constrain the recognition of revenue from variable consideration through the determination of the transaction price rather than by creating a separate constraint. The boards decided to remove the exception for intellectual property licences where payments vary based on the customer's subsequent sales (for example, a sales-based royalty) and instead clarified that the underlying principle for constraining revenue applies to all contracts with customers. The boards also clarified that the constraint applies to contracts with a variable price and to contracts with a fixed price where it is uncertain whether the entity will be entitled to that consideration even after the performance obligation is satisfied. The boards removed the term 'reasonably assured' to avoid confusion as that term has different meanings under current IFRS and US GAAP.
Time value of money	The transaction price should reflect the time value of money when the contract includes a significant financing component. As a practical expedient, an entity is not required to reflect the effects of the time value of money in the measurement of the transaction price when the period between payment by the customer and the transfer of the goods or services is less than one year.	The boards retained the proposed guidance, and clarified three items: • An entity paid in advance for goods or services need not reflect the effects of time value of money when the transfer of those goods or services to the customer is at the discretion of the customer. • The practical expedient may be applied to contracts where the term may be greater than one year, but the timing difference between payment and performance is one year or less. • Interest income is not precluded from being presented as a component of revenue.



Topic	November 2011 exposure draft	Tentative decision
Allocation of transaction price	The transaction price is allocated to separate performance obligations based on the relative stand-alone selling price of the performance obligations in the contract. A residual value approach may be used as a method to estimate the stand-alone selling price when there is significant variability or uncertainty in the selling price of a good or service, regardless of whether that good or service is delivered at the beginning or end of the contract. Some elements of the transaction price, such as uncertain consideration, discounts, or change orders, may be allocated to only one performance obligation rather than all performance obligations in the contract under certain circumstances.	The boards decided to retain the residual approach as an appropriate technique to estimate the stand-alone selling price of a good or service if that stand-alone selling price is highly variable or uncertain. The boards also clarified that the residual approach may be used in contracts in which there are two or more goods or services that have highly variable or uncertain stand-alone selling prices. When there are two or more goods or services with highly variable or uncertain stand-alone selling prices, the boards clarified that an entity could use a combination of techniques to estimate their stand-alone selling prices by: • first applying the residual approach to estimate the aggregate of the stand-alone selling prices for all of the goods or services with highly variable or uncertain stand-alone selling prices; and • then using another technique to estimate the individual stand-alone selling prices relative to the aggregate stand-alone selling price. Guidance related to allocation of some elements of the transaction price, such as uncertain consideration, discounts, or change orders, to one or more performance obligations rather than all performance obligations in the contract under certain circumstances, was retained. The boards also decided to clarify that the guidance in the new revenue standard related to allocating the transaction price can be applied to a portfolio of contracts or to performance obligations with similar characteristics if the entity expects that doing so would not result in materially different outcomes from applying the guidance to an individual contract or performance obligation.

1 Identify the contract(s) with the customer
2 Identify and separate performance obligations
3 Determine the transaction price
4 Allocate the transaction price
5 Recognise revenue when a performance obligation is satisfied

Topic	November 2011 exposure draft	Tentative decision
Performance obligations satisfied over time	A performance obligation is satisfied over time if (a) the entity's performance creates or enhances an asset that the customer controls, or (b) the entity's performance does not create an asset with alternative use to the entity and one of the following criteria is met: • the customer simultaneously receives and consumes the benefits of the entity's performance as it performs; • another entity would not need to substantially reperform the task(s) if that other entity were required to fulfill the remaining obligation to the customer; or • the entity has a right to payment for performance completed to date and it expects to fulfill the contract.	The boards decided to make the following refinements to the criteria for determining whether an entity satisfies a performance obligation over time and, hence, recognises revenue over time: • Retain the criterion that considers whether the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced. • Combine the 'simultaneous receipt and consumption of benefits' criterion and the 'another entity would not need to substantially reperform' proposed criterion into a single criterion that would apply to 'pure service' contracts. • Link more closely the 'alternative use' criterion and the 'right to payment for performance completed to date' criterion by combining them into a single criterion. The boards also decided to clarify aspects of the 'alternative use' and 'right to payment for performance completed to date' criteria. For example: • The assessment of alternative use is made at contract inception and that assessment considers whether the entity would have the ability throughout the production process to readily redirect the partially completed asset to another customer. • The right to payment should be enforceable and, in assessing the enforceability of that right, an entity should consider the contract terms as well as any legislation, regulation, or legal precedent that could override those contract terms.

Topic	November 2011 exposure draft	Tentative decision
Measuring progress toward satisfying a performance obligation	The objective of measuring progress is to faithfully depict the pattern of transfer of goods or services to the customer. Methods for recognising revenue when control transfers continuously include: • Output methods that recognise revenue on the basis of the value of the entity's performance to date (for example, surveys of goods or services transferred to date, appraisals of results achieved). • Input methods that recognise revenue on the basis of inputs to the satisfaction of a performance obligation (for example, time lapsed, resources consumed, labour hours expended, costs incurred, and machine hours used). An entity may select an appropriate input method if an output method is not directly observable or available to an entity without undue cost. The effects of any inputs that do not represent the transfer of goods or services to the customer, such as abnormal amounts of wasted materials, should be excluded from the measurement of progress. It may be appropriate to measure progress by recognising revenue equal to the costs of the transferred goods if the costs of goods are significant and transferred at a significantly different time from the related service (such as materials the customer controls before the entity installs the materials).	The boards retained the guidance for measuring progress toward satisfying a performance obligation over time. The boards tentatively decided that methods such as ‘units produced’ or ‘units delivered’ could provide a reasonable proxy for the entity’s performance in satisfying a performance obligation in the following circumstances: • A ‘units produced’ method could provide a reasonable proxy for the entity’s performance if the value of any work in progress at the end of the reporting period is immaterial. • A ‘units delivered’ method could provide a reasonable proxy for the entity’s performance if: 1. the value of any work in progress at the end of the reporting period is immaterial; and 2. the value of any units produced but not yet delivered to the customer at the end of the reporting period is immaterial. They also agreed to clarify the accounting for uninstalled materials, wasted materials, and inefficiencies when using an input method to better meet the objective of measuring progress to depict the pattern of transfer of goods or services to the customer.

Other considerations

Topic	November 2011 exposure draft	Tentative decision
Licences and rights to use	The promised rights are a performance obligation that the entity satisfies when the customer obtains control (that is, the use and benefit) of those rights. An entity should consider whether the rights give rise to a separate performance obligation or whether the rights should be combined with other performance obligations in the contract.	The boards decided that in some cases a licence is a promise to provide a right, which transfers to the customer at a point in time. In other cases, a licence is a promise to provide access to an entity's intellectual property, which transfers benefits to the customer over time. Indicators will be provided to help determine the accounting based on the nature of the licence and the commercial substance of the agreement.
Onerous performance obligations	An entity should recognise a liability and corresponding expense if a performance obligation that is satisfied over a period of time is onerous. The performance obligation will not need to be assessed if it is satisfied over a period less than one year. A performance obligation is onerous if the lowest cost of settling the performance obligation exceeds the amount of transaction price allocated. The lowest cost of settling a performance obligation is the lower of the following: • the costs directly related to satisfying the performance obligation; and • the amount the entity would have to pay to exit the performance obligation.	The boards decided to remove this guidance from the scope of the revenue standard. The IASB decided that the requirements for onerous contracts in IAS 37, ‘Provisions, contingent liabilities and contingent assets’, should apply to all contracts with customers in the scope of the revenue standard. The FASB decided to retain existing guidance related to the recognition of losses arising from contracts with customers, including the guidance relating to construction-type and production-type contracts in Subtopic 605-35, ‘Revenue recognition— construction-type and production-type contracts’.
Collectibility	Collectibility of the transaction price is not a hurdle to revenue recognition. The transaction price is presented without adjustment for credit risk. An allowance for the expected impairment loss on customer receivables is presented in a separate line item adjacent to revenue. Both the initial impairment assessment and any subsequent changes in the estimate of collectibility are recorded in this line (if the contract does not have a significant financing component).	The boards decided that initial and subsequent impairments of customer receivables, to the extent material, should be presented prominently as an expense below gross margin. This presentation should be followed regardless of whether the contract with the customer has a significant financing component.
Contract acquisition costs	An entity should recognise an asset for the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs. A practical expedient is provided that allows an entity to recognise incremental costs to obtain a contract as an expense if the amortisation period of the asset would be one year or less.	The boards retained the requirement to capitalise incremental contract acquisition costs if an entity expects to recover those costs. The boards also retained the practical expedient that allows an entity to expense costs to obtain a contract if the amortisation period of the asset would be one year or less.

Topic	November 2011 exposure draft	Tentative decision
Transition	The proposed guidance would be applied retrospectively. However, an entity may use one or more of the following practical expedients: • An entity can elect not to restate contracts that begin and end within the same annual reporting period. • An entity may use the transaction price at the date the contract was completed rather than estimating variable consideration for contracts completed on or before the effective date. • An entity does not have to apply the onerous performance obligation test to performance obligations in comparative periods unless an onerous contract liability was recognised previously. • An entity is not required to disclose the amount of the transaction price allocated to remaining performance obligations with an explanation on the timing of revenue recognition (the so-called 'maturity analysis'). The effective date of the proposed standard will be no earlier than annual periods beginning on or after 1 January 2015. Earlier adoption will not be permitted under US GAAP, although it will be permitted under IFRS.	The boards decided that an entity can either apply the final standard retrospectively or use the following practical expedient to simplify transition: • apply the revenue standard to all existing contracts as of the effective date and to contracts entered into subsequently; • recognise the cumulative effect of applying the new standard to existing contracts in the opening balance of retained earnings on the effective date; and • disclose, for existing and new contracts accounted for under the new revenue standard, the impact of adopting the standard on all affected financial statement line items in the period the standard is adopted. An entity that uses this practical expedient must disclose this fact in its financial statements. The revenue standard will be effective for annual reporting periods beginning on or after 1 January 2017. Early application will not be permitted under either IFRS or US GAAP.

130311-135345-HH-OS