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Agenda paper 12.1



Australian Government
Australian Accounting Standards Board

Revenue from Contracts with Customers

AASB Education Session
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Agenda

Overview of ED/2011/6

Preliminary issues identified by AASB staff

AASB staff draft project plan

Questions

The objective of the draft IFRS is to establish the principles that an entity shall apply to report useful information to users of financial statements about the amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer.

(ED/2011/6, paragraph 8)



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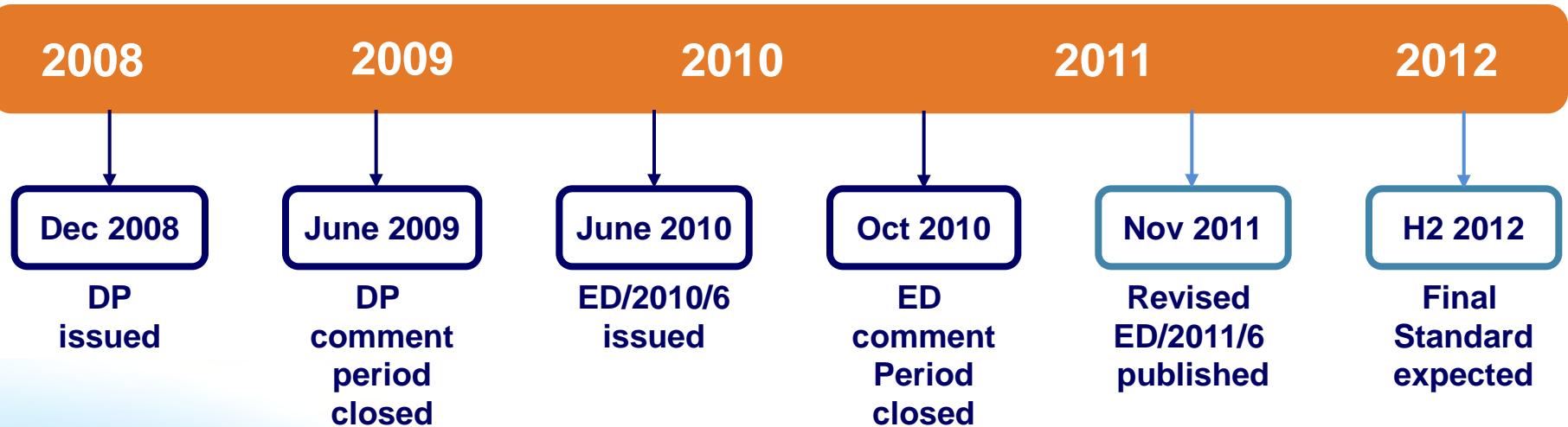
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Overview of ED/2011/6 *Revenue from Contracts with Customers*



Background

Project added to the IASB agenda in 2002 as part of IASB and FASB work programme towards convergence

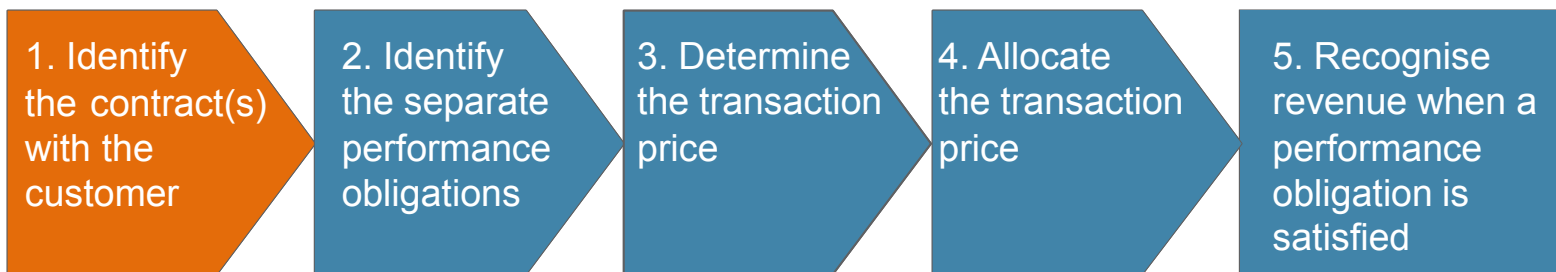




Core principle of revenue proposals

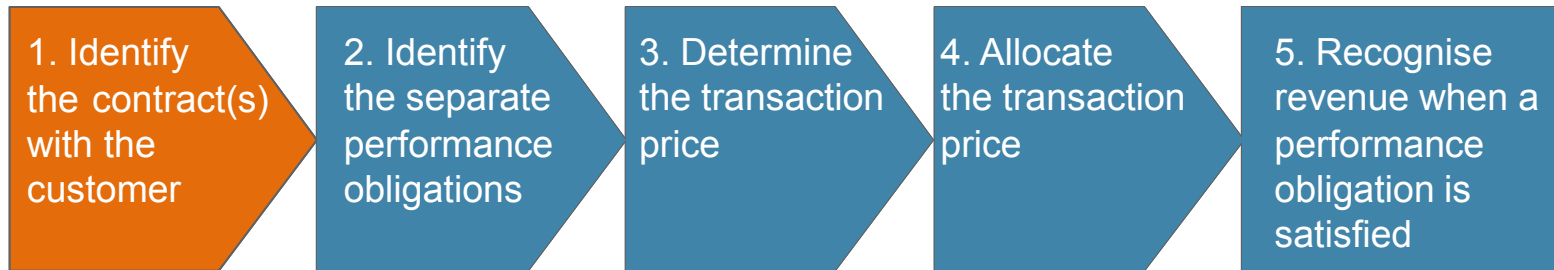
Recognise revenue on transfer of goods or services to customer at an amount that reflects the amount of consideration **to which the entity expects to be entitled** in exchange for those goods or services

Steps to apply the core principle:





Step 1: Identify the contract with the customer



Key proposal: identify contractual rights and obligations

- contracts combined if they meet certain criteria
- contract modifications
 - accounted for as a separate contract if goods or services are distinct and reflect stand alone selling price
 - otherwise re-evaluate remaining performance obligations



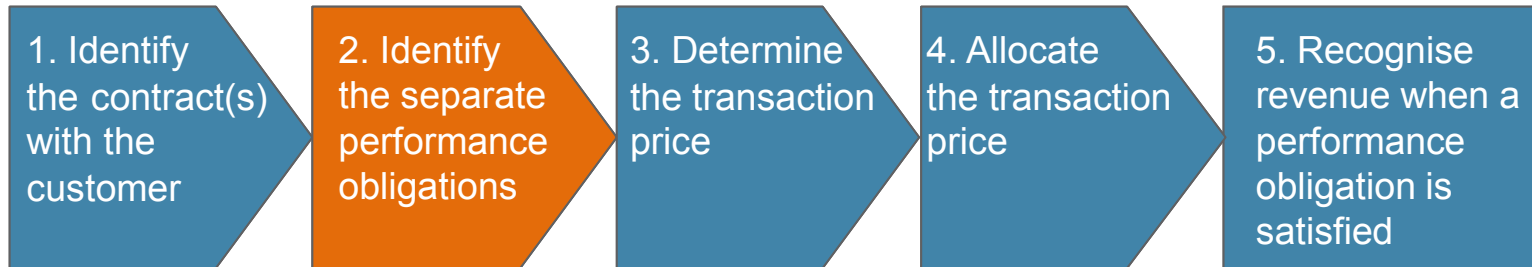
Step 1: Identify the contract with the customer (cont.)

Key changes from ED/2010/6

- indicators on combining contracts elevated to be criteria
- eliminated the proposal on contract segmentation (now incorporated into Step 4)
- proposals on contract modifications revised



Step 2: Identify separate performance obligations



Key proposal: identify distinct goods or services

- a good or service is distinct if either:
 - the entity regularly sells the good or service separately or
 - the customer can benefit from the good or service on its own or together with other readily available resources
- one performance obligation if highly inter-related and significant integration or significantly customised



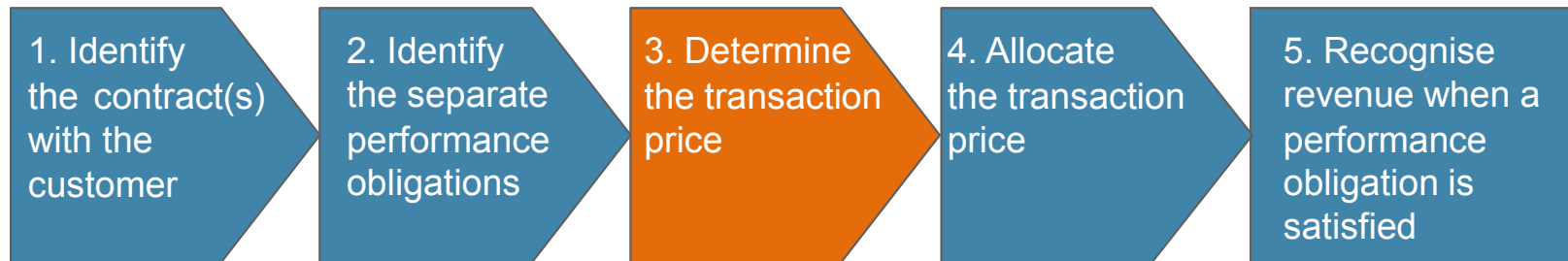
Step 2: Identify separate performance obligations (cont.)

Key changes from ED/2010/6

- deleted “enforceable” from definition of performance obligation
- clarified proposals for identifying separate performance obligations



Step 3: Determine the transaction price



Key proposal: consideration expected to be entitled to

- transaction price – amount of consideration expected in exchange for goods or services
- uncertain consideration → expected value or most likely amount
- consideration included in transaction price if “reasonably assured”



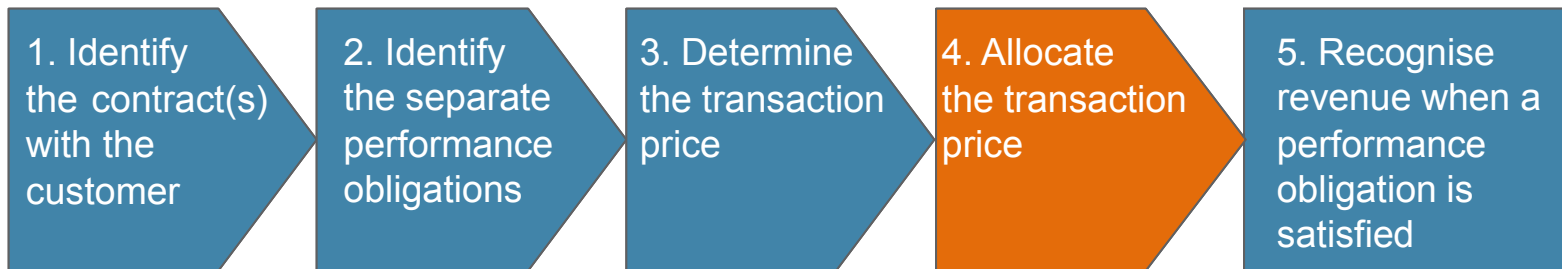
Step 3: Determine the transaction price (cont.)

Key changes from ED/2010/6

- modified the definition of transaction price → the amount to which the entity “expects to be **entitled**” rather than “expected amount to be **received**”
- credit losses no longer included in the transaction price
- time value of money only considered if > 1 year
- variable consideration
 - use expected value or most likely amount



Step 4: Allocate the transaction price



Key proposal: relative selling price allocation

- allocate transaction price to separate performance obligations on relative stand-alone selling price basis
- estimate if necessary
- may use residual technique to estimate stand-alone selling price of performance obligation with high variability in price



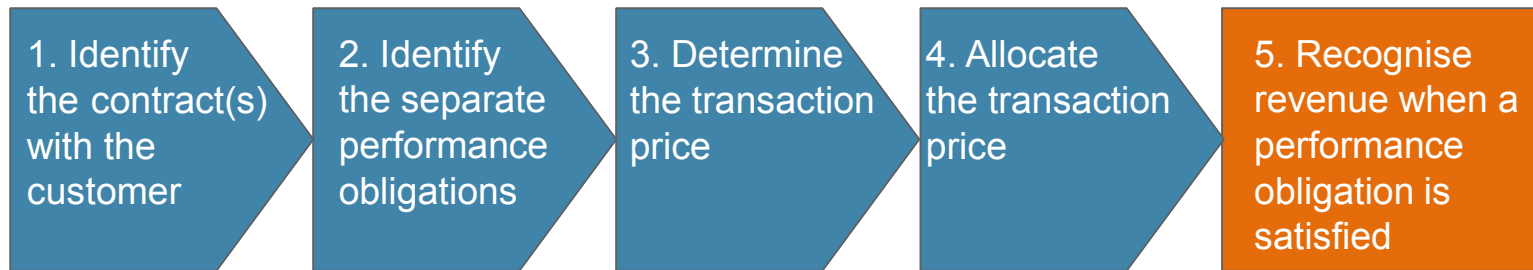
Step 4: Allocate the transaction price

Key changes from ED/2010/6

- residual technique permitted
- added guidance on allocation of discounts and changes in transaction price



Step 5: Recognise revenue



Key proposal: transfer of goods or services

- recognise revenue when performance obligation is satisfied by transferring good or service to the customer
- transfer occurs when customer obtains control
- transfer can be continuous (satisfied over time)



Step 5: Recognise revenue

Performance obligations satisfied over time

An entity satisfies a performance obligation and recognises revenue over time if at least one of the following criteria is met:

- the entity's performance creates or enhances an asset (for example, WIP) 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 at least one of the following criteria is met:
 - the **customer receives a benefit** as the entity performs.
 - another entity would not need to **substantially reperform** the work the entity has performed to date if that other entity were to fulfil the remaining obligation to the customer...
 - the entity has a **right to payment** for its performance to date and the entity expects to fulfil the contract as promised....



Step 5: Recognise revenue

Key changes from ED/2010/6

- “risks and rewards of ownership” added as an indicator of control passing
- “performance obligations satisfied over time” criteria added
- “reasonably assured” criterion added



Example 1*

A telecommunications company sells a mobile phone and unlimited calls to Customer A on a 12 month contract. The phone is free and the network service is \$40 per month.

The same company sells the same mobile phone to Customer B for \$300 and the network service is \$15 per month.

The total minimum payable under both contracts is \$480

Likely current accounting

Revenue from:

Customer A: \$40 per month

Customer B: \$300 up front
\$15 per month

Applying the new proposals

Revenue from:

Customer A and Customer B:

\$300 up front
\$15 per month

* Adapted from IASB Staff Presentation Zurich Conference July 2011



Example 2

- An entity enters into a contract with a customer to construct a warehouse facility for \$100 million over 2 years. The expected cost of fulfilling the contract is \$80 million.
- The contract involves the design and construction of the warehouse facility. It is therefore concluded that the contract involves highly interrelated goods and services.
- Constructing the warehouse requires a significant service of integrating the goods and services in the form of project management services.
- The warehouse is customised to the customer's requirements.



Example 2 (cont.)

Scenario 1

- The entity measures revenue on the basis of costs incurred (input method).
- At the end of year 1 the entity has incurred \$20 million of costs relative to the total \$80 million of expected costs.
- Therefore, the entity estimates that the performance obligation is 25% complete and recognises revenue of \$25 million ($\$100 * 25\%$).
- Subsequently, the entity continues to recognise revenue on the basis of costs incurred relative to total expected costs.



Example 2 (cont.)

Scenario 2

- The entity measures revenue on the basis of value to the customer (output method).
- At the end of year 1 the entity has incurred \$20 million of costs relative to the total \$80 million of expected costs.
- The value to the customer of the work performed to date is estimated to be \$30 million.
- Therefore, the entity estimates that the performance obligation is 30% complete and recognises revenue of \$30 million ($\$100 * 30\%$).



Disclosure

- Extensive disclosure requirements, including:
 - reconciliation of contract balances
 - reconciliation of onerous performance obligations
 - determining the transaction price and allocating it to performance obligations
 - reconciliation of assets arising from the costs incurred to obtain or fulfil a contract with a customer



Transition

- Retrospective application
- Transition relief:
 - for contracts that begin and end in the same comparative reporting period
 - to allow the use of hindsight in estimating uncertain consideration
 - not to require the onerous test in comparative periods
 - not to require disclosure of the maturity analysis of performance obligations for comparative periods



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Preliminary issues identified by AASB staff



Preliminary issues identified by AASB staff

Transfer of control over time

- right to payment for goods or performance to date should be a necessary condition to recognise revenue
- “reperformance” criterion either redundant or inconsistent with the principle

Multi-unit multi level real estate sales

- unclear how to interpret the term ‘alternative use’
- may result in diversity in practice as different accounting outcomes may arise depending on whether an asset has an ‘alternative use’



Preliminary issues identified by AASB staff (cont.)

Input v output methods

- input methods provide a constant margin over time
- output methods provide a variable margin
- unclear which method is preferred in the ED

Scope / Interaction with IFRS 9 / IAS 39

- measurement of refund liabilities
 - IAS 39 → fair value (“deposit floor”)
- unclear whether contract assets are scoped out of IAS 39/IFRS 9



Preliminary issues identified by AASB staff (cont.)

Variable consideration

- disagree with choice → expected value or most likely amount

Reasonably assured

- inconsistent with the Conceptual Framework
- higher threshold than 'probable'

Onerous test

- disagree with \leq one year exception



Preliminary issues identified by AASB staff (cont.)

Contra revenue

- disagree with revenue recognised at a net amount

Time value of money

- disagree with using significance and the 'one year' practical expedient

Disclosure

- disclosure requirements appear to be excessive



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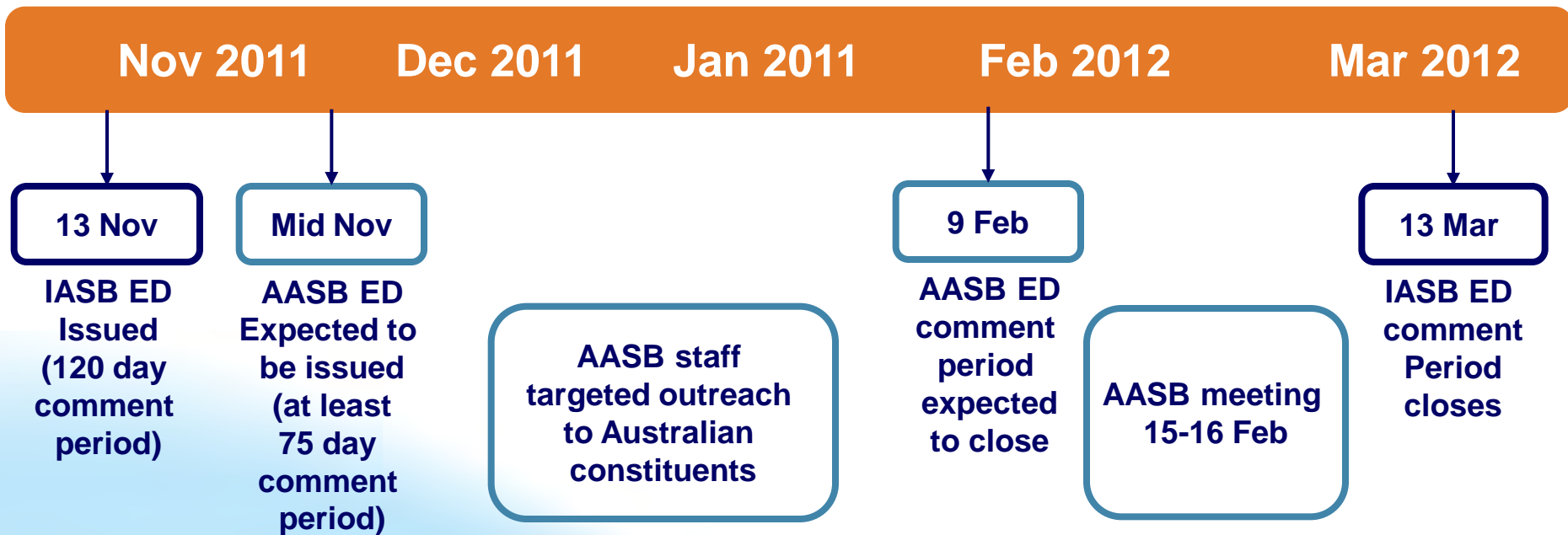
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AASB staff draft project plan



AASB staff draft project plan

Based on the publication date of the IASB's ED, below is a draft project plan for AASB staff.





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Discussion