

Extract from *IASB Update* – February 2011

Revenue recognition

The FASB and IASB discussed identification of separate performance obligations, revenue recognition for services, combining contracts, contract modifications, definition of a performance obligation, breakage and prepayments for future goods or services, and onerous performance obligations.

Identification of separate performance obligations

The boards continued their discussions from January 2011 on identifying the separate performance obligations in a contract with a customer. The boards tentatively decided that:

- a. An entity should account for a bundle of promised goods or services as one performance obligation if the entity provides a service of integrating those goods or services into a single item that the entity provides to the customer.
- b. An entity should account for a promised good or service as a separate performance obligation if:
 - i. the pattern of transfer of the good or service is different from the pattern of transfer of other promised goods or services in the contract, and
 - ii. the good or service has a distinct function.
- c. A good or service has a distinct function if either:
 - i. the entity regularly sells the good or service separately, or
 - ii. the customer can use the good or service either on its own or together with resources that are readily available to the customer.

This approach for identifying separate performance obligations was supported by all members of both boards.

Revenue recognition for services

The boards continued their discussions from January 2011 on how an entity would recognise revenue for services. The boards tentatively decided that to recognise revenue for a service, an entity must determine that a performance obligation is satisfied continuously and must then select a method for measuring progress toward complete satisfaction of that performance obligation.

The boards tentatively decided that an entity satisfies a performance obligation continuously if at least one of the following two criteria is met:

- a. The entity's performance creates or enhances an asset that the customer controls as the asset is being created or enhanced, or
- b. the entity's performance does not create an asset with an alternative use to the entity and at least one of the following conditions is met:

- i. the customer receives a benefit as the entity performs each task, or
- ii. another entity would not need to reperform the task(s) performed to date if that other entity were to fulfil the remaining obligation to the customer, or
- iii. the entity has a right to payment for performance to date even if the customer could cancel the contract for convenience.

These decisions were supported by all members of both boards.

To clarify how an entity should measure progress toward complete satisfaction of a performance obligation, the boards tentatively decided that the final revenue standard should:

- a. emphasise that the objective of measuring progress is to faithfully depict the entity's performance (ie the pattern of transfer of goods or services to a customer), and
- b. clarify the descriptions in the exposure draft of output and input methods.

This decision was supported by all members of both boards.

The boards also discussed some issues that arise when an entity uses an input method of measuring progress toward complete satisfaction of a single performance obligation. In some cases, an entity merely procures goods that are transferred at a different time from related services (eg materials that the customer controls before the entity installs the materials). In those cases, the boards tentatively decided that an entity should measure progress by recognising revenue for the transfer of those goods in an amount equal to the costs of the transferred goods.

This decision was supported by 14 members of the IASB with 1 disagreeing and 4 members of the FASB with 1 disagreeing.

Combining contracts

The boards tentatively decided that an entity should combine, and account for as a single contract, two or more contracts that are entered into at or near the same time with the same customer (or related entities) 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 in one contract depends on the other contract, and
- the goods and services in the contracts are interrelated in terms of design, technology, or function.

All the IASB and FASB members supported this decision.

The staff will consider further the implications of limiting the combination of contracts to contracts with the same customer (or related entities).

Contract modifications

The boards tentatively decided that if a contract modification results only in the addition of a separate performance obligation or obligations at a price that is commensurate with that additional performance obligation, the entity should account for the contract modification as

a separate contract. Otherwise, the entity should re-evaluate the performance obligation and reallocate the transaction price to each separate performance obligation.

No formal vote was taken because the boards have not yet redeliberated how an entity would determine and allocate the transaction price. However, no board members objected to the tentative decision.

Definition of a performance obligation

The boards decided to amend the definition of a performance obligation by deleting the word 'enforceable'.

All the IASB and FASB members supported this decision.

Breakage and prepayments for future goods or services

The boards discussed the accounting for a customer's non-refundable prepayment for future goods or services and the portion of the customer's rights that is not exercised (often referred to as breakage). The boards tentatively decided that if an entity can reasonably estimate the amount of expected breakage, the entity should recognise the effects of the expected breakage as revenue in proportion to the pattern of rights exercised by the customer. Otherwise, the entity should recognise the effects of the expected breakage when the likelihood of the customer exercising its remaining rights becomes remote.

This decision was supported by 10 members of the IASB. Only 2 FASB members supported this approach as their preferred method. However because 4 FASB members said that they would not object to this approach, the FASB agreed to support the decision.

Onerous performance obligations

The boards began discussing issues in applying the test to assess whether performance obligations are onerous. The boards tentatively decided that the unit of account for the onerous test should be the contract, specifically the remaining performance obligations in the contract.

This decision was supported by 12 members of the IASB with 3 disagreeing and by 3 members of the FASB with 2 disagreeing.

Next steps

At their meetings in March, the boards will discuss onerous contracts, determining the transaction price (including variable consideration, collectibility, and the time value of money), allocating the transaction price, and contract costs.