

# Revenue from contracts with customers

One model. Two approaches.  
Five steps.

One more chance to comment.

November 2011, Issue 2011/35

IN THE HEADLINES

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“ It’s good news that the Boards listened to much of the feedback on the first round of proposals. All interested parties now have one more chance to influence a new standard on revenue.”

– Phil Dowad, KPMG’s global IFRS revenue recognition leader

## **One model; two approaches; five steps; one more chance to comment**

The exposure draft (ED) proposes a single model that would apply to all contracts with customers and two approaches to recognising revenue: over time or at a point in time.

The model features a contract-based five-step analysis of transactions to determine whether and how much revenue is recognised. The five steps would be:

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

Companies have one more chance to comment on the proposal. The deadline for comments is 13 March 2012.

## **Revenue recognition may be accelerated or deferred**

Revenue may be recognised over time, similar to current stage of completion accounting, or at a point in time, similar to current sales of goods accounting. The ED proposes new criteria to determine when revenue would be recognised over time.

For complex transactions with multiple components and/or variable amounts of consideration, or when the work is carried out under contract for an extended period of time, the application of the proposals may lead to revenue being accelerated or deferred in comparison with current IFRS requirements.

## **New estimates and judgements required**

New estimates and judgemental thresholds would be introduced that could affect the amount and/or timing of revenue recognised when consideration is variable or contingent, or when dividing a contract into separate components. Significant judgement may be required to determine how these estimates and thresholds apply to you.

The new estimates and judgements might be particularly difficult to apply if you are launching a new business line or new products, or entering a new market.

## **Stage of completion has been revived**

The ED proposes new criteria to determine when revenue would be recognised over time. These criteria address fact patterns such as construction contracts and contracts for services.

The Boards have listened to the concerns of constituents and have amended previous proposals. The range of goods and services captured by such criteria could be far broader than under earlier versions of the proposals.

Nevertheless, if you currently use the stage of completion method, or otherwise enter into long-term contracts, the proposal would have you reconsider whether to recognise revenue on contract completion or as the contract is fulfilled.

Making this assessment based on the provided criteria would require a detailed review of contract terms and, for contracts for the sale of real estate, property law.

## **Provisioning is done at the performance obligation level**

The proposal would push the assessment of a contract loss from the contract level down to the performance obligation level. An entity would recognise a liability and an expense if a separate performance obligation to be satisfied over a period of time greater than one year is onerous.

A performance obligation is onerous if the lowest cost of settling the performance obligation exceeds the amount of the transaction price allocated to the performance obligation.

The proposal differs from current practice in a number of ways. This may result in changes in the circumstances in which an entity recognises a liability and/or the amount of the liability.

## **New disclosure requirements could be revealing**

The proposals include extensive new disclosure requirements. Companies may have to redesign, and in many cases significantly expand, the information captured about unfulfilled performance obligations to draft the notes to the financial statements dealing with revenue.

The proposed disclosure could convey important additional information about business practices and prospects to investors and competitors.

## **Retrospective application**

Companies would apply the proposals retrospectively unless one of the limited practical expedients would be met.

The retrospective application may require companies to introduce new processes and systems well in advance of the new standard's effective date and to run those systems and processes in parallel with existing systems.

## **New systems and processes**

The proposed estimates, thresholds and disclosure requirements may lead to changes in systems and processes to capture and review the required data, for the current and comparative periods. These changes may be necessary even if there is no effect on the numbers.

Processes might need to be reconsidered to ensure that management judgement is exercised at the key points as financial information is prepared.

## **The impacts may be felt right across your organisation**

All of your financial ratios may be affected, which could impact your share price or access to capital. Changes to the timing of revenue recognition may affect the timing of tax payments and the ability to pay dividends in some jurisdictions. Staff bonuses and incentive plans might have to be reconsidered to ensure they remain aligned with your corporate goals.

Investors and other stakeholders will want to understand the impact of the proposals on your business.

For companies in the most affected sectors, there also are wider business implications to consider, including contract terms, employee incentives and communications with investors and analysts.

## **You need to start looking at your contracts now ...**

“The most affected companies could be those with bundled products and services or those engaged in construction activities – for example, the telecoms, software and engineering industries.”

– Gary Reader, leader, KPMG's global IFRS initiative

## Basic facts

ED/2011/6 *Revenue from Contracts with Customers* was issued by the IASB on 14 November 2011.

The proposed standard would replace IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IFRIC 13 *Customer Loyalty Programmes*, IFRIC 15 *Agreements for the Construction of Real Estate*, IFRIC 18 *Transfer of Assets from Customers*, SIC 31 *Revenue – Barter Transactions Involving Advertising Services*.

The earliest effective date would be for periods beginning 1 January 2015.

The comment period for the proposals ends on 13 March 2012.

This is a joint project between the IASB and the FASB, which would result in a joint standard.

## Timeline<sup>1</sup>



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Publication name: *In the Headlines – Revenue from contracts with customers*

Publication number: Issue 2011/35

Publication date: November 2011

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<sup>1</sup> Assumes a 31 December annual reporting date.