

Boards to re-expose revenue proposal, delaying project to seek comments

What you need to know

- ▶ The Boards decided to formally expose their joint revenue recognition proposal for a second time.
- ▶ The decision will delay the project, possibly until September 2012 according to the staff paper presented to the Boards, but will give constituents a chance to comment on the changes.
- ▶ Retrospective adoption at the effective date will be required, although certain specific relief will be available.
- ▶ The onerous test will be performed at the performance obligation level, but the test will apply only to performance obligations satisfied over time.

We strongly support the Boards' decision to give constituents a chance to formally comment on the revised proposals.

Overview

At its most recent meeting, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) (collectively, the Boards) elected to formally expose their revenue recognition proposal for a second time. The decision will likely delay completion of the project, but will give constituents a chance to comment on the changes.

In addition, the Boards have also addressed transition guidance, onerous performance obligations, use of a residual technique to estimate standalone selling price and amortisation and impairment of fulfillment and contract acquisition assets.

Decision to re-expose the proposed guidance

While not required to satisfy the requirements of due process, the Boards elected to formally re-expose the proposed revised model. The re-exposure is expected to target certain aspects of the proposed revised model that represent a substantial change from the original Exposure Draft (ED), including: determining when a performance obligation is satisfied over time; presenting the effects of credit risk adjacent to revenue; recognition constraints for uncertain consideration; and application of the onerous test to performance obligations satisfied over a long period of time.

The Boards did not provide a definitive time line, but the staff paper presented to the Boards estimated that a new exposure draft would likely be published in August or September 2011. The Boards agreed to provide a 120-day comment period.

Without re-exposure, the Boards had hoped to issue a final standard by the end of 2011. The staff paper presented to the Board indicated a final standard may now only be issued by September 2012.

The onerous test would apply only to performance obligations satisfied over time, not those satisfied at a point in time.

How we see it

While re-exposure will delay the project, we strongly support the Boards' decision to give constituents another opportunity to formally comment on the proposals. During their redeliberations over the past six months, the Boards have been very responsive to input from constituents and, as a result, have changed a number of aspects of the model, which may significantly impact certain industries. We believe constituents need an opportunity to re-evaluate the model and to provide the Boards with feedback. In addition, re-exposure will allow constituents to consider the drafting and operational effectiveness of the proposed standard.

The latest on onerous performance obligations

The Boards have once again changed the proposed model on how entities should determine whether their contracts with customers contain onerous performance obligations. The Boards have now tentatively concluded that companies need to assess whether a performance obligation is onerous only for performance obligations satisfied over time. Performance obligations satisfied at a point in time would not be subject to such an assessment. While the Boards do not explicitly state this in their summary of decisions, we believe the phrase "satisfied over time" refers to both services or goods bundled with services representing a single performance obligation satisfied continuously.

It is unclear whether this decision will complement or negate a previous decision by the Boards to perform the onerous test taking into consideration all *remaining* performance obligations. The decision appears to have moved this assessment back to the *individual* performance obligation level as originally proposed in the ED.

The Boards also modified the costs to be considered in performing the onerous test. When determining whether a performance obligation is onerous, the model would now require the entity to consider the lesser of: (1) the costs directly related to satisfying the performance obligation, and (2) the amount the entity would have to pay to exit the contract.

How we see it

The Boards' decision to scope out performance obligations satisfied at a point in time (i.e., goods) simplifies the model for the onerous test.

However, applying the onerous test only to performance obligations satisfied over time would require an entity to apply the test to only some of the performance obligations in a multiple-element arrangement that includes goods and services. We believe this approach could lead to counterintuitive results. For example, this model could result in the recognition of a loss for individual performance obligations (e.g., a low-margin service) in a contract that is profitable as whole, resulting in recognition of a loss at contract inception that is later recovered through profits on the satisfaction of other performance obligations in the contract.

Costs incurred in fulfilling a contract

The Boards further clarified the proposed accounting for capitalised contract acquisition and contract fulfilment costs.

The proposed guidance would require an entity to amortise assets arising from fulfilment costs and contract acquisition costs consistent with the pattern of transfer of the related goods and services. The Boards clarified that assets may be amortised over periods longer than the term of the initial contract (i.e., including expected renewals). The Boards also decided to allow immediate expense recognition for contract acquisition costs related to contracts with a duration of one year or less.

Under the proposed guidance, an entity would recognise an impairment loss when the carrying amount of the capitalised asset exceeds the amount of the transaction price allocated to the remaining performance obligations less the costs that relate directly to satisfying those performance obligations (i.e., the recoverable amount). The Boards decided that the recoverable amount may consider amounts expected to be received from contracts not yet executed or from anticipated contract renewals.

Required disclosures

Despite concerns raised by constituents about the level of disclosure required by the ED, the Boards generally affirmed the proposed disclosure requirements during their redeliberations.

Transition to the new standard

For many entities, one of the more problematic areas of a new revenue standard may be the transition from current practice. The Boards proposed in the ED that entities should apply the new standard retrospectively to ensure that revenue presented for each period has been determined consistently.

The Boards recently affirmed their earlier decision to require retrospective application, but also agreed to provide the following relief from full retrospective application:

- ▶ Entities would not be required to restate comparative periods for contracts that begin and end within the same annual accounting period.
- ▶ Entities would be able to use hindsight in estimating variable consideration in the transaction price.
- ▶ Entities would not be required to perform an onerous test in comparative periods unless a liability previously existed for an onerous contract.
- ▶ Certain ongoing disclosures required in the proposed model would not be required for comparative periods.

The proposed standard would allow full retrospective application for entities that choose not to apply the relief provided. Entities that choose to adopt the final standard using some or all of the types of relief would be required to provide additional qualitative disclosures, such as which types of relief were chosen and the likely effects of applying them.

What's next

The Boards have substantially completed their redeliberations on the proposed revenue model. Given the Boards' approval process, the new exposure draft is expected to be issued in August or September 2011.

This is our third publication on the Boards' redeliberations of the proposed revenue model. Earlier decisions made by the Boards can be found in:

- ▶ *Supplement to IFRS Outlook Issue 99: New revenue recognition model is taking shape*
- ▶ *Supplement to IFRS Outlook Issue 101: Another step towards a final revenue standard*

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