IASB and FASB decide to make more changes to their new revenue standards

What you need to know

- The IASB and the FASB agreed to amend the transition requirements in their new revenue standards.
- The Boards reached different decisions on whether to amend the requirements for non-cash consideration, presentation of sales taxes and collectability.
- The Boards’ staffs provided updates on their research on how to address concerns about the application guidance on principal versus agent considerations.
- Any changes to the standards will be subject to the Boards’ due process procedures, including seeking public comment.

Highlights

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) (collectively, the Boards) agreed to add practical expedients to their new revenue standards to make it easier for entities to account for contract modifications at transition. The IASB decided to add a practical expedient for completed contracts under the full retrospective transition approach. The Boards also reached different decisions on how to address questions that have arisen on the requirements for non-cash consideration, presentation of sales taxes and collectability.

It is unclear whether the Boards’ tentative decisions on the amendments to the new revenue standards will lead to diversity in practice between IFRS and US GAAP preparers.

The IASB plans to issue one exposure draft in June 2015 that incorporates its decisions from the February and March 2015 meetings and any additional amendments it determines necessary. The FASB plans to issue separate proposals for decisions made at each of the meetings.

At the March 2015 meeting, the Boards’ staffs also discussed their research on possible changes to the application guidance on principal versus agent considerations. The Boards are expected to address this issue soon.
Boards’ tentative decisions

Transition – contract modifications and completed contracts

The Boards agreed to add practical expedients to their new standards to alleviate the transition burden of accounting for contracts that were modified prior to adoption under both transition approaches (i.e., full and modified retrospective). This assessment could be onerous for entities that have multi-year contracts that have been modified many times.

The Boards agreed to add a practical expedient such that an entity would not be required to evaluate the effects of each contract modification from contract inception through to the ‘contract modification adjustment date’ (CMAD), which the Boards defined differently. Instead, an entity would determine the contract’s transaction price at the CMAD (with the benefit of hindsight) and then perform a single allocation of the transaction price to all satisfied and unsatisfied performance obligations, based on their historical stand-alone selling prices. Any modifications after the CMAD would be accounted for under the new standard. An entity would be required to apply this practical expedient to all contracts with similar characteristics.

The IASB decided that the CMAD would be the beginning of the earliest period presented under either transition approach, which may vary for IFRS preparers depending on the number of years they present in their financial statements (e.g., 1 January 2016 for an entity that has a calendar year-end and includes only one comparative period in its financial statements). The FASB decided that the CMAD would be the beginning of the earliest period presented under the new standard (i.e., 1 January 2015 or 1 January 2017 for a calendar-year public entity using the full or modified retrospective approach, respectively).

The IASB also directed its staff to draft a practical expedient that would allow an entity that uses the full retrospective approach to only apply the new standard to contracts that are not completed as at the beginning of the earliest period presented. A contract would be considered completed if the entity has transferred all of the goods and services identified under existing revenue standards and interpretations before the date of initial application. Both of the new revenue standards already allow a similar accounting treatment for entities that choose to use the modified retrospective approach.

The FASB decided not to add this practical expedient. As a result, on adoption, US GAAP preparers that elect the full retrospective approach will need to evaluate whether any contracts that are considered ‘completed’ under today’s US GAAP requirements have outstanding performance obligations under the new standard.

The FASB also decided to add a technical correction to its transition requirements to clarify that an entity that uses the full retrospective approach does not need to disclose the effect of the accounting change on affected financial statement line items in the period of adoption (e.g., 2017), as would otherwise be required by Accounting Standards Codification 250, Accounting Changes and Error Corrections. This technical correction would align with an existing exemption for IFRS preparers transitioning to the new standard.

Non-cash consideration

Stakeholders have raised questions about the date that should be used when measuring the fair value of non-cash consideration for inclusion within the transaction price. In addition, constituents noted that the variability of non-cash consideration could arise both from its form (e.g., shares) and for other reasons (e.g., performance factors that affect the amount of consideration to which the entity will be entitled). Consequently, they questioned how the constraint on variable consideration would be applied in such circumstances.
At this stage, the IASB does not plan to propose any clarifications to the standard to address either question until this issue can be considered in conjunction with other emerging issues and outreach activities.

The FASB decided that the fair value of non-cash consideration would be measured at contract inception. That is, an entity would measure the fair value only once (at contract inception, if there is no variable consideration) when determining the transaction price. Any subsequent changes in the fair value of the non-cash consideration would be recognised, if required, in accordance with other accounting standards, but would not be recognised as revenue from contracts with customers. The FASB also clarified that when the variability of non-cash consideration is due to both its form and for other reasons, the constraint on variable consideration would apply only to the variability for reasons other than its form.

**How we see it**

It is not yet clear whether the IASB will propose any clarifications in relation to non-cash consideration. As such, it is unclear whether the FASB’s decision to propose that the fair value of non-cash consideration be measured at contract inception would result in diversity in practice between IFRS and US GAAP preparers.

**Presentation of sales taxes**

The new revenue standards require that any “amounts collected on behalf of third parties (for example, some sales taxes)” must be excluded from the transaction price. In practice, this will require entities to evaluate taxes collected in all jurisdictions in which they operate to determine whether a tax is levied on the entity or the customer. Current IFRS requires entities to make similar judgements.

Under current US GAAP, an entity is permitted to make an accounting policy election to present in-scope sales taxes on either a gross basis (i.e., included in revenue and expenses) or a net basis (i.e., excluded from revenue) with accompanying disclosure requirements.

The FASB decided to add a practical expedient that would allow an entity to present revenue net of certain types of taxes, including sales, use, excise, value-added and franchise taxes (collectively referred to as sales taxes) with disclosure of the policy. The IASB decided that a practical expedient is not necessary as the topic was not an interpretative question, but a concern expressed by stakeholders in the US as to the operability of the requirements under US GAAP.

**Collectability**

The new standards state that if an arrangement does not meet the criteria (including the collectability criterion) to be considered a contract, an entity will recognise non-refundable consideration received as revenue only when one of two events has occurred: (1) it has completed performance and received substantially all consideration; or (2) the contract has been terminated. Stakeholders have questioned whether the Boards intended for this requirement to indefinitely delay the recognition of non-refundable cash consideration in a number of situations (e.g., a month-to-month service arrangement when the entity continues to perform). Stakeholders have also asked whether a contract would be considered ‘terminated’ when the entity stops providing the good or service, or only when the entity stops pursuing collection from the customer.

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1 IFRS 15.47
2 IAS 18.8
The IASB was not asked to vote on this issue and its staff recommended undertaking more research before bringing it back for discussion at a future IASB meeting.

The FASB tentatively decided to clarify that a contract would be terminated when an entity has the ability to stop transferring goods or providing services and has actually done so. The FASB also tentatively decided to refine the requirements in the Step 1 collectability threshold and/or add or amend examples to clarify that an entity would consider the probability of collecting the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer, rather than the total amount promised.

For example, in a service contract with a stated three-year term that either party could terminate with two months’ notice without penalty, the evaluation would only reflect the two-month non-cancellable period in the contract. However, this analysis would only determine whether the entity has a valid contract under the new standard and would not affect the contractual term that is considered when applying the rest of the requirements in the standard (e.g., for purposes of determining or allocating the transaction price).

Research project update
Principal versus agent considerations
The Boards’ staffs discussed their research on possible improvements to the principal versus agent application guidance. Under the new standards, an entity is a principal (and, therefore, recognises revenue on a gross basis) if it controls the promised good or service before transferring it to the customer. An entity is an agent (and recognises the net amount it retains as a commission as revenue) if its only role is to arrange for another entity to provide the good or service.

The IASB staff indicated that IFRS constituents have raised fewer questions about this application guidance under IFRS than under US GAAP, but it will continue to perform further research and outreach activities before bringing it back to the Board for discussions in May 2015.

The FASB staff said the new standard will not resolve many of the questions about the application of current US GAAP. The FASB staff also noted that stakeholders believe the new standard will likely generate new questions, such as how to apply the new principles for transfer of control of goods or services when determining whether an entity is a principal or an agent.

The FASB staff said it could explore improvements for both current standards and the new revenue standard. This may involve: clarifying the principle underlying all principal versus agent determinations; amending the indicators; adding examples that involve intangible (or virtual) goods or services; and clarifying if/when a principal would estimate gross revenue.

Next steps
The Boards’ latest decisions are tentative and they will seek public comment on any changes they propose. The FASB will decide at a meeting in April 2015 whether to propose delaying the effective date of its standard. It is not yet clear whether the IASB will consider a similar deferral.