Issue 120 / May 2016

IFRS Developments

IASB debriefs the April 2016 FASB TRG meeting on revenue

What you need to know

- At its May 2016 meeting, the IASB received an oral update of the April 2016 FASB TRG meeting.
- At its April 2016 meeting, the FASB TRG discussed three implementation issues relevant in an IFRS context related to accounting for material rights, performance obligations satisfied over time and contract assets.
- TRG members representing IFRS constituents did not participate in the April 2016 meeting. However, certain members of the IASB and its staff observed the meeting.

Overview

At its May 2016 meeting, the International Accounting Standards Board (IASB) received an oral update on the meeting of the Financial Accounting Standards Board (FASB) Transition Resource Group for Revenue Recognition (FASB TRG) held on 18 April 2016. At the April 2016 meeting, the FASB TRG discussed five implementation issues, three of which are relevant in both IFRS and US GAAP. The FASB TRG members expressed diverse views on the question related to the accounting for material rights, but generally agreed on the issues related to performance obligations satisfied over time and contract assets. The other two US GAAP-only issues relate to scoping considerations for assets managers and financial institutions.[1]

This publication outlines the topics discussed by the FASB TRG in April 2016 that are relevant in an IFRS context and, where possible, indicates if members of the IASB or its staff commented further.

The IASB and FASB (collectively, the Boards) created the Joint Transition Resource Group for Revenue Recognition (TRG) to help them determine whether more application guidance is needed on their new revenue standards[2] and to educate their constituents. The joint TRG met six times in 2014 and 2015, and the Boards have amended their standards to address some of the issues discussed by the TRG.

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[1] For more information, see our US *To The Point publication FASB Transition Resource Group for Revenue Recognition discusses five more implementation issues* (SCORE No. 00649-161US) available on EY AccountingLink.

[2] IFRS 15 *Revenue from Contracts with Customers* and Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*.

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In January 2016, the IASB announced that it did not plan to schedule further meetings of the IFRS constituents of the TRG, but it would continue to monitor any discussions of the FASB TRG.

While the TRG members' views are non-authoritative, entities should consider them as they implement the new revenue standards. James Schnurr, Chief Accountant of the US Securities and Exchange Commission (SEC), expects SEC registrants to use the TRG discussions and meeting minutes to inform their implementation of the standards and has said that his office strongly encourages registrants, including foreign private issuers (which may report in IFRS), that want to use accounting that differs from the TRG views to discuss their accounting with the SEC staff.[3]

Considering 'class of customers' when evaluating whether a material right exists

FASB TRG members expressed diverse views on how an entity would consider a 'class of customers' when determining whether a customer option to acquire additional goods or services (e.g., future sales incentives, loyalty programs, renewal options) represents a material right. FASB TRG members generally agreed that the determination would likely require an entity to exercise significant judgement and consider all facts and circumstances. However, they did not agree on how to make those judgements.

The new revenue standards require that when an entity grants a customer the option to acquire additional goods or services, that option is a separate performance obligation (and, therefore, requires revenue to be allocated to it at contract inception) if it provides a material right that the customer would not receive without entering into the contract. Examples include a discount that exceeds the range of discounts typically given for those goods or services to that class of customers in that region or market. An option would not provide a material right if a customer could execute a separate contract to obtain the same goods or services at the same price.

FASB TRG members expressed diverse views on several aspects of this determination. For example, they had differing perspectives about which situations would require the identification of a 'class of customers' and which customers would appropriately make up a comparable customer class. They also had differing views about how prior purchases would affect the determination of a material right. In the staff paper on this issue, the FASB staff presented four examples illustrating its view on how a class of customers is considered when evaluating whether a customer option gives rise to a material right. Some of these examples were discussed by the FASB TRG members, but, due to their open questions on the application of the guidance, it was not clear whether FASB TRG members would reach consistent conclusions on those examples.

As a next step, the FASB staff will convene a meeting of stakeholders in the travel and entertainment industries to discuss the issue further because it is a significant implementation issue for many entities in these industries.

How we see it

Significant judgement may be required to determine whether a customer option represents a material right. As such, we support continuing the dialogue on this issue. This determination is important because it will affect the accounting treatment and disclosures for a contract at inception and throughout the life of a contract.

[3] Speech by James V. Schnurr, 22 March 2016. Refer to SEC website at http://www.sec.gov/news/speech/schnurr-remarks-12th-life-sciences-accounting-congress.html.

FASB TRG items of general agreement

Evaluating how control transfers for performance obligations satisfied over time

Under the new revenue standards, an entity will determine at contract inception whether it satisfies a performance obligation (and, therefore, recognises revenue) over time or at a point in time. When an entity determines that a performance obligation is satisfied over time, the standards require the entity to select a single measure of progress (using either an input or output method) that depicts its performance in transferring the good or service in order to recognise revenue as it performs.

FASB TRG members generally agreed that, if a performance obligation meets the criteria for revenue to be recognised over time (rather than at a point in time), control of the underlying good or service is not transferred at discrete points in time. Because control transfers as an entity performs, an entity's performance (as reflected using an appropriate measure of progress) should not result in the creation of an asset (e.g., work in progress).

Stakeholders had asked whether control of a good or service underlying a performance obligation that is satisfied over time can be transferred at discrete points in time because the new revenue standards highlight several output methods, including 'milestones reached', as potentially acceptable methods for measuring progress toward satisfaction of an over-time performance obligation. FASB TRG members generally agreed that an entity could use an output method only if that measure of progress correlates to the entity's performance to date.

At the May 2016 IASB meeting, IASB staff indicated support for the conclusions reached in the staff paper on this issue, noting that it provides some clarity about when to use milestones reached as a measure of progress. Furthermore, the members of the IASB who observed the FASB TRG meeting indicated that the TRG discussion on the topic was helpful.

Accounting for contract assets when a contract is modified

Under the new standards, a contract asset is created when an entity has satisfied a performance obligation (and, therefore, recorded revenue relating to that performance obligation), but does not yet have an unconditional right to consideration. This may be, for example, because the entity must first satisfy another performance obligation in the contract before it can invoice the customer. Stakeholders queried how an entity would account for a contract asset that exists when a contract is modified if the modification is treated as the termination of an existing contract and the creation of a new contract.

FASB TRG members generally agreed that a contract asset that exists when a contract is modified should be carried forward into the new contract if the modification is treated as the termination of an existing contract and the creation of a new contract.

Some stakeholders had questioned the appropriate accounting treatment for contract assets when this type of modification occurs, because the termination of the old contract could indicate that any remaining balances associated with the old contract should be written off.

FASB TRG members generally agreed that it is appropriate to carry forward the related contract asset in such modifications because the asset relates to a right to consideration for goods and services that have already been transferred and are distinct from those to be transferred in the future. As such, the revenue recognised to date would not be reversed and the contract asset would continue to be realised as amounts become due from the customer and are presented as a receivable.

Next steps

The FASB has scheduled two more FASB TRG meetings this year, in July and November. The IASB will continue to monitor any discussions of the FASB TRG. Stakeholders can submit implementation issues for discussion via the IASB's or FASB's websites.

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ED None