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IFRS Global office
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IFRS in Focus

IASB issues revised exposure draft on revenue recognition

Contents

The Bottom Line

- The underlying approach in the revised ED is broadly consistent with that of the original ED and, like IAS 11 and IAS 18, is driven primarily by a model of recognising revenue as an entity delivers goods and services to a customer. However, the revised ED contains more detailed guidance than existing IFRSs and many changes have been made regarding the application of the model.
- One significant change from the original ED is the introduction of a restriction on 'unbundling' performance obligations within a contract when an entity provides a significant service of integrating the elements of the contract into a combined item and the elements are significantly modified or customised.
- A loss may be recognised at contract inception on specific elements of a contract even though the overall contract or portfolio of contracts is expected to be profitable.
- The ED sets out guidance on the circumstances in which revenue may be recognised even though the total consideration to be received is uncertain.
- Extensive financial statements disclosures would be required.
- The revised proposals would be effective no earlier than for annual periods beginning on or after 1 January 2015 with early application permitted.
- The comment period ends on 13 March 2012, with a final standard expected to be published at the end of 2012.

The proposal

On 14 November 2011, the International Accounting Standards Board (IASB) issued a re-exposure draft ED/2011/6 *Revenue from Contracts with Customers* ('the revised ED'). The revised ED is the next step in developing an entirely new revenue recognition standard and follows extensive outreach and redeliberations on the proposals in the original ED that was issued in June 2010. Although the underlying conceptual basis is unchanged, the IASB and the US Financial Accounting Standards Board (FASB) (collectively 'the Boards') changed many detailed aspects of the original ED's proposals. As a result of these changes, and given the importance of the revenue line item to users of financial statements, the Boards decided to expose for public comment a revised ED. The Boards are seeking comments from constituents on whether the proposals are clear and can be applied in a way that effectively communicates to users of financial statements the economic substance of an entity's contracts with customers.

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

The Boards invite comments on six specific areas in the revised ED on which constituents previously have not had the opportunity to comment:

1. determining when a performance obligation relating to the transfer of a good or service is satisfied over time;
2. presenting the effects of a customer's credit risk as a separate line item adjacent to the revenue line item;
3. constraining the cumulative amount of revenue recognised to date to amounts to which an entity is reasonably assured to be entitled;
4. applying the onerous test to a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year;
5. requiring revenue disclosures in interim financial reports; and
6. determining when to derecognise transferred non-financial assets that are not an output of an entity's ordinary activities.

The objective of this project is to develop a common, comprehensive, principles-based revenue standard that can be applied consistently to complex transactions across a wide range of industries. The Boards expect that the revised proposals will be a significant improvement over the current revenue recognition guidance.

The revised ED's core principle is that "an entity shall recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services." The proposals list five key steps for entities to follow in recognising revenue for contracts within the revised ED's scope:

- Step 1 – identify the contract with a customer;
- Step 2 – identify the separate performance obligations in the contract;
- Step 3- determine the transaction price;
- Step 4- allocate the transaction price to the separate performance obligations in the contract; and
- Step 5 – recognise revenue when (or as) the entity satisfies each performance obligation.

These steps are consistent with those identified in the original ED; however various changes have been proposed to their implementation as described below.

Identifying contracts with customers

In a manner consistent with the proposals in the original ED, the revised ED would apply to an entity's contracts with customers other than those within the scope of the leasing, insurance or financial instruments standards and non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers other than the parties to the exchange. A contract must be with a customer, can be written, oral or implied and must create enforceable rights and obligations between two or more parties. The revised ED provides specific criteria for entities to consider in determining whether a contract exists. If all parties to a *wholly unperformed* contract can unilaterally terminate the contract without penalty, a contract would not be deemed to exist.

Observation

Entities will need to identify all customer contracts and understand their key terms to ensure that the new model is appropriately applied. This may include understanding the practices and processes for establishing contracts in an entity's legal jurisdiction and the customary business practices of an entity and its industry.

Contract combination

The Boards revised and refined the original ED's proposed guidance on combining contracts. The revised ED would require that an entity combine two or more contracts that are entered into at or near the same time with the same customer (or related parties) 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 paid in one contract depends on the price or performance of the other contract; or
- goods or services in two or more of the contracts constitute a single performance obligation.

Contract segmentation

The original ED proposed that a contract would be accounted for "as two or more contracts if the price of some goods or services in the contract is independent of the price of other goods or services in the contract." The Boards decided to eliminate this proposed requirement because they considered it unnecessary. Thus, all decisions about separation would be part of the process of identifying separate performance obligations (see further discussion below).

Contract modification

The revised ED would require an entity to account for modifications to the scope or pricing of a contract as separate contracts if the modification results in the addition of promised goods or services that are 'distinct' and the amount of additional consideration reflects the entity's stand-alone selling price including any appropriate adjustments. Otherwise, the entity would identify the remaining performance obligations in the contract (including partially satisfied obligations) and account for the modified contract as follows:

- if the remaining goods or services are distinct from those already transferred, allocate the modified transaction price less the amount of consideration allocated to completely satisfied performance obligations to each remaining separate performance obligation;
- if the remaining goods or services are not distinct and are part of a single performance obligation that is partially satisfied at the date of modification, update the transaction price and the percentage of completion for the contract as a whole (resulting in a catch-up adjustment on a cumulative basis at the date of modification).

The original ED proposed the use of the second approach for all modifications with pricing interdependent with that of the original contract; this attracted criticism as the resulting 'catch up' adjustment was not considered to reflect economic substance.

Identifying separate performance obligations

Both the original and revised ED's propose that a good or service would be accounted for as a separate performance obligation if it is deemed 'distinct'. The original ED deemed an obligation to be distinct if the good or service is sold separately or could be sold separately because it has a distinct function and profit margin, raising concerns from many, particularly in the construction industry, that this could lead to identification of an unmanageably high number of performance obligations within a single contract. The revised ED responds to these concerns by refining the definition of 'distinct'.

Per the revised ED and except as explained below, a good or service is distinct if either of the following criteria is met:

a) the entity regularly sells the good or service separately; or

b) the customer can benefit from the good or service either on its own or together with resources that are readily available to the customer.

Notwithstanding those criteria, a good or service in a bundle of promised goods or services is not distinct, and therefore the bundle of goods or services would be treated as a single performance obligation, if both of the following criteria are met:

a) the goods or services in the bundle are highly interrelated and transferring them to the customer requires the entity also to provide a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted; and

b) the bundle of goods or services is significantly modified or customised in order to fulfill the contract.

The revised proposals note that, as a practical expedient, an entity may account for two or more distinct goods or services as a single performance obligation if those goods or services have the same pattern of transfer to the customer (e.g., if applying one method of measuring progress for the distinct goods or services would faithfully depict the transfer of those goods or services to the customer).

Observation

The restriction on unbundling 'highly interrelated' elements of a contract may require careful consideration by, for example, entities that supply a core software product together with associated professional services such as customisation and integration. It is possible in such circumstances that the licence and services may be combined and treated as a single performance obligation resulting in the recognition of all revenue over time.

In evaluating whether a bundle of goods or services should be accounted for as separate performance obligations, entities will need to consider a number of factors including the extent of integration, the level of customisation and the sequence of when performance obligations are satisfied because a customer may not be able to use a good or service until another good or service within the same contract is delivered.

Determining the transaction price

The original ED proposed that if the transaction price is subject to variability, an entity would be required to use a probability weighted estimate of the transaction price if such an estimate can reasonably be made. The revised ED clarifies that "the transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties." The transaction price would include discounts, rebates, refunds, credits, incentives, performance bonuses, penalties, concessions and other similar items. The estimation would reflect available historical, current and forecasted information and would be based on either the probability-weighted amount or the most likely amount (i.e., management's best estimate), "depending on which method the entity expects to better predict the amount of consideration to which it will be entitled." One method would need to be applied consistently throughout the contract.

Observation

The Boards' proposal to allow the use of a best estimate approach in certain circumstances would alleviate concerns relating to unreliable estimates where there is a lack of information or required use of a mathematical average that does not correspond to either of two possible outcomes.

Time value of money

The original ED and the revised ED are consistent in requiring that the transaction price would be adjusted to reflect the time value of money when the financing component is significant to the contract. Given the subjectivity associated with determining whether a financing component is 'significant' to the contract, the revised ED provides factors an entity should consider in making this determination:

- the expected time period between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services;
- whether the amount of consideration would be substantially different if the customer paid in cash promptly in accordance with typical credit terms; and
- the interest rate in the contract and prevailing interest rates in the relevant market.

The revised ED notes that an entity should use "the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception." In addition, as a practical expedient, if at contract inception the period between the transfer of goods or services and ultimate payment is expected to be one year or less, an assessment of whether there is a significant financing component is not required.

Non-cash consideration

The revised ED would require an entity to measure non-cash consideration at fair value if that value can reasonably be estimated. If this not the case, the consideration would be measured indirectly by reference to the stand-alone selling price of the goods or services promised. When a customer contributes goods or services which the entity then controls to facilitate an entity's fulfilment of the contract, the entity would account for the contribution as non-cash consideration received from the customer.

Consideration payable to a customer

The revised ED notes that "consideration payable to a customer includes amounts that an entity pays, or expects to pay, to a customer (or to other parties that purchase the entity's goods or services from the customer) in the form of cash, credit or other items that the customer can apply against amounts owed to the entity." Consideration payable to a customer is treated as a reduction of the transaction price unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity.

Collectability

The revised ED would require estimates of expected credit losses (both the initial estimate at the transaction date and subsequent adjustments) to be recognised in a separate line item within the statement of comprehensive income adjacent to the gross revenue line item. This differs from the original ED which proposed inclusion of the initial estimate within gross revenue. The revised ED does not require an assessment of the customer's ability to pay the promised amount of consideration as a pre-condition for recognising revenue.

Observation

Entities may need to assess the implications of any potential change to the presentation of financial results on key performance indicators such the gross margin ratios as the effects of credit risk will now be shown within the gross margin.

Allocating the transaction price to separate performance obligations

The original ED proposed that an entity should "allocate the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the good or service underlying each of those performance obligations at contract inception (i.e., on a relative stand-alone selling price basis)." The revised ED provides more flexibility in the estimation method used when the stand-alone selling price of a good or service is not directly observable. For example, a residual technique may be the most appropriate method for a performance obligation with a highly variable or uncertain stand-alone selling price. Discounts would generally be allocated to all separate performance obligations based on the relative stand-alone selling price unless each good or service is regularly sold separately and the observable selling price provides evidence of the performance obligation(s) to which the entire discount relates.

If the transaction price includes consideration that is contingent on a future event or circumstance, the entity would allocate that contingent amount and related subsequent changes entirely to one performance obligation (unlike the requirement proposed in the original ED to allocate subsequent changes in the transaction price to all performance obligations in the contract) when both of the following criteria are met:

- the contingent payment terms of the contract relate specifically to the entity's efforts to satisfy that performance obligation or to a specific outcome from satisfying that separate performance obligation; and
- allocating the contingent amount entirely to that particular performance obligation is consistent with the ED's allocation principle, i.e., overall it reasonably reflects the amount of consideration to which the entity expects to be entitled in exchange for satisfying each performance obligation.

All other subsequent changes in the transaction price would need to be allocated to the separate performance obligations on the same basis as at contract inception. Amounts allocated to a satisfied performance obligation would be recognised as revenue, or as reduction of revenue, in the period in which the transaction price changes.

Recognising revenue as the performance obligations are satisfied

The original ED introduced the concept of 'control' in the determination of when a good or service transfers to a customer and thus, when revenue is recognised, which may be at a point in time or over a period. In producing the revised ED, the Boards decided to modify the proposed indicators of when a customer obtains control at a point in time and to provide additional guidance that an entity must consider in determining whether control transfers continuously over time (including clarifying how an entity should measure its progress towards completion of a performance obligation that is continuously satisfied).

Transfer of control at a point in time

The revised ED carries forward most of the proposed guidance in the original ED. However, the Boards decided to describe the concept of control instead of specifically defining it, to remove the indicator of control that states that the design or function of the good or service is customer-specific and to add 'risks and rewards of ownership' as an indicator of control.

Transfer of control over a period

For an entity to recognise revenue over a period, it must first conclude that a performance obligation is continuously satisfied, and then select a method to measure progress towards completion. An entity satisfies a performance obligation continuously if at least one of the following two criteria is met:

1. The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced (e.g., the customer controls the work-in-progress).

2. The entity's performance does not create an asset with alternative use to the entity (e.g., the contract does not allow the entity to sell the work-in-progress to another customer or the work-in- progress is highly customised and would not be suitable for another customer) and at least one of the following criteria is met:

   a. The customer simultaneously receives and consumes the benefit as the entity performs each task;

   b. Another entity would not need to substantially re-perform the work completed to date if that other entity were to fulfill the remaining obligation to the customer (without having access to work-in-progress or any other asset controlled by the entity); or

   c. The entity has a right to payment (assuming that the seller complies fully with its contractual obligations) for performance completed to date and expects to fulfill the contract as promised. If the customer cannot cancel the contract, or the full contract price is payable on cancellation, this would appear to meet the criteria. If the contract can be cancelled by the customer and a fixed amount is payable on cancellation, which is lower than the total contract price, this may not be considered to be sufficient to compensate for performance to date and therefore may not satisfy this criterion.

For each separate performance obligation that an entity satisfies over time, an entity would choose a method of measuring the progress towards completion and recognise revenue by consistently applying that method. Appropriate methods of measuring progress include output methods and input methods.

If an entity uses an input method to measure progress towards completion, and goods are transferred to the customer significantly before the related services (e.g., materials that are controlled by the customer before the related service is provided by the entity), the ED indicates that the best depiction of performance may be for the entity to recognise revenue for the transfer of those goods equal to their costs (i.e., at nil margin) if:

- the cost of the transferred goods is significant relative to the total expected costs to completely satisfy the performance obligation; and
- the entity procures the goods from another entity and is not significantly involved in designing and manufacturing the goods (but the entity is acting as a principal).

Observation

One of the main criticisms of the original ED was that there was inadequate guidance on services. The revised ED contains considerably more guidance. It is expressed in a way that initially looks quite unfamiliar; but in many cases, items that are treated as services under IAS 18 would be classified as performance obligations satisfied over a period under the revised ED.

For a customised service contract where the customer controls the work-in-progress as the asset is being assembled, the revenue associated with that service would be recognised over the period of the contract. For service contracts where the customer does not control the work-in-progress, an entity would need to determine whether an asset is created with an alternative use to the entity. An asset with alternative use is an asset that the entity could readily direct to another customer. All facts and circumstances would need to be considered including the contract terms, the significance of the costs involved to reconfigure the asset, discounts that would need to be provided to sell the asset to another customer and consequences to the entity (including legal ramifications) of directing the asset to another customer. An entity that determines that an asset does not have an alternative use must also meet one of the three criteria noted above to recognise revenue over time.

During the Boards' redeliberations, their staff provided some examples of the types of services that may give rise to a continuous transfer of control on the basis of the first two criteria (assuming that the customer does not control the work-in-progress and the entity's performance does not create an asset with alternative use to the entity).

Examples include:

- an entity that processes transactions on behalf of a customer because the customer receives a benefit as each transaction is processed; and
- an entity that provides shipping services for a customer because another entity would not need to reperform the shipment of goods that are provided to date.

In evaluating whether an entity has a right to payment for performance to date, the entity must have a right to a fixed or variable amount that is intended to at least compensate the entity for its performance to date even if the customer can terminate for convenience (i.e., for reasons other than the entity's failure to perform as promised). Compensation for performance to date would include payment for recovery of the entity's costs plus a reasonable profit margin rather than compensation for only the entity's potential loss of profit if the customer cancels the contract.

There is also a subtle but significant shift in focus for construction-type activity. The existing guidance in IAS 11 and IFRIC 15 focuses on whether an item is being constructed to a customer-specific design. The revised ED instead focuses on whether the asset under construction has 'alternative use' to the entity. This may result in a different analysis in some cases, particularly for some property contracts.

Constraining the cumulative amount of revenue recognised

For contracts with variable consideration, the revised ED imposes an additional constraint on the cumulative amount of revenue recognised, being that this should not exceed the amount to which it is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount of consideration allocated to satisfied performance obligations only if both of the following criteria are met:

- the entity has experience with similar types of performance obligations (or has other evidence such as access to the experience of other entities); and
- the entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.

Observation

This constraint was added to the revised ED to address revenue amounts which may be 'reasonably estimated' but nevertheless may never be received, for example an asset management fee based upon market values at a future date or royalty payments based on the licensee's future sales volumes.

Onerous performance obligations

The revised ED retains the requirement of the original ED to assess for individual onerous performance obligations at inception of a contract, but limits that assessment to performance obligations that are satisfied over time and which are expected, at contract inception, to be satisfied over a period of greater than one year. The costs used in such a test and measurement of the onerous liability would be the lower of the direct costs to satisfy the performance obligation and the amount that the entity would have to pay to exit the performance obligation if the entity is permitted under the contract to do so other than by transferring the promised goods or services.

Observation

The revised ED limits, but does not eliminate, the possibility that individual onerous performance obligations will result in the recognition of a loss at inception of a profitable contract.

Costs of fulfilling or obtaining a contract

Costs of fulfilling a contract would be capitalised if "the costs relate directly to a contract (or a specific anticipated contract), the costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future and the costs are expected to be recovered." Examples of such costs might include direct labour and direct materials. However, general and administrative costs and costs of wasted materials would generally not be capitalised. The revised ED also clarifies that the costs that relate directly to a contract include costs that are incurred before the contract is obtained if those costs relate specifically to an anticipated contract (i.e., pre-contract costs).

Whereas the original ED proposed that costs of obtaining a contract should be expensed, the revised ED proposes that the incremental costs of obtaining a contract with a customer should be recognised as an asset if the entity expects to recover those costs. Those incremental costs are the costs that an entity incurs in its efforts to obtain a contract with a customer and that it would not have incurred if the contract had not been obtained (for example, a sales commission). Costs that would have been incurred regardless of whether the contract was obtained should be recognised as an expense when incurred, unless they are explicitly chargeable to the customer regardless of whether the contract is obtained.

As a practical expedient, acquisition costs incurred may be expensed instead of capitalised for those contracts with an expected duration of one year or less.

Capitalised costs should be amortised "on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates." The period may extend beyond the initial contract term with the customer (e.g., considering contract renewals and related subsequent sales).

Implementation guidance

Warranties

The original ED proposed different accounting for warranties depending on whether they provide coverage for defects existing when the product is transferred to the customer or for faults arising subsequent to transfer. However, respondents to the original ED raised concerns over how practicable it would be to determine when a defect occurred. As a result, the revised ED proposes the following differentiation on a different basis:

- If a customer has the option to purchase a warranty separately from the entity, the entity should account for the warranty as a separate performance obligation. Hence, the entity would allocate revenue to the warranty service.
- If a customer does not have the option to purchase a warranty separately from the entity, the entity would account for the warranty as a cost accrual unless the warranty provides a service to the customer in addition to assurance that the product complies with agreed-upon specifications (in which case the entity would account for the warranty service as a separate performance obligation).

The revised proposals indicate that when determining whether the exception in the second criterion applies, the entity would consider whether the entity is required by law to provide a warranty, the length of the warranty coverage period and the nature of the tasks that the entity promises to perform.

Licences and rights to use

The revised ED eliminates the original ED's accounting model for exclusive licences and rights to use an entity's intellectual property. Accordingly, sales of licences and rights to use intellectual property will be subject to the ED's overall revenue recognition model. Revenue cannot be recognised before the beginning of the period during which the customer can use and benefit from the licensed intellectual property.

Sales and repurchase agreements

Certain contracts provide for the sale of an asset to a customer and simultaneously provide the entity the unconditional right or obligation to repurchase the asset (a call option or forward contract) from the customer. The revised ED stipulates that such a transaction would be accounted for as a lease if the repurchase amount is less than the original selling price of the asset. Otherwise, the repurchase transaction would be treated as a financing arrangement. However, if the customer holds a put option, the entity would need to determine whether the customer has a significant economic incentive to exercise that right. If so, the contract would be accounted for as a lease. If not, the contract would be accounted for similar to a sale of a product with a right of return.

Breakage on prepayments for future goods or services

The original ED did not specifically address how to recognise revenue for customers' rights that are not exercised (i.e., breakage on prepayments) when only a single performance obligation exists in the contract. Examples include gift cards sold to customers or reward points earned by customers that expire unused. Under the revised ED, if an entity is reasonably assured of the amount of expected breakage, the entity would recognise the effects of the expected breakage in proportion to the pattern of rights exercised by the customer. Otherwise, the expected breakage would be recognised when the likelihood of the customer exercising its remaining rights becomes remote.

Annual disclosure and presentation requirements

The Boards determined that with the exception of minor amendments and clarifications (as detailed below), the guidance on presentation and disclosure in the original ED would be retained.

Disaggregation of revenue

The original ED proposed that revenue be disaggregated into categories that best depict how the amount, timing and uncertainty of revenues and cash flows are affected by economic characteristics and included examples of categories that might be appropriate. The revised ED includes the following examples of possible categories: type of good or service, geography, market or type of customer, type of contract and contract duration.

Presentation of contract assets and liabilities

A contract asset would be recognised in the statement of financial position if an entity performs before the customer pays consideration and a contract liability would be recognised if the customer pays consideration before the entity performs. The revised ED would permit the use of other terminology, provided that sufficient information is available to users to distinguish between conditional (i.e., contract assets) and unconditional rights to consideration (i.e., accounts receivable). Net contract assets and net contract liabilities would be presented as separate line items in the statement of financial position. A liability for onerous contracts would be presented separately from contract assets and contract liabilities.

Reconciliation of contract assets and contract liabilities

The revised ED would require that an entity disclose a reconciliation in tabular format from the opening to the closing aggregate balance of contract assets and contract liabilities. The reconciliation should disclose, where applicable: amounts recognised in the statement of comprehensive income arising from revenue from performance obligations satisfied during the period, revenue from allocating changes in the transaction price to performance obligations satisfied in previous reporting periods, cash received, amounts transferred to receivables, non-cash consideration received and the effect of business combinations. Further, additional line items would be included in the reconciliation if users would need them to understand the change in contract assets and contract liabilities.

Disclosure of performance obligations

The revised ED would require an entity to disclose information about its performance obligations and would require the following disclosures for contracts with an original expected duration of more than one year:

- the aggregate amount of the transaction price allocated to remaining performance obligations; and
- an explanation of when the entity expects to recognise that amount as revenue.

An entity may disclose when it expects those amounts to be recognised as revenue, either on a quantitative basis in time bands that would be most appropriate for the duration of the contract or by using qualitative information.

Disclosure about assets from contract acquisition or fulfilment costs

Entities should disclose a reconciliation of the carrying amount of an asset arising from the costs to acquire or fulfil a contract with a customer, by major classification (e.g., acquisition costs, pre-contract costs and set up costs) at the beginning and end of the period as well as a description of the method used to determine the amortisation of those costs for the period.

Other disclosures

The revised ED would require additional disclosures for onerous performance obligations and disclosures relating to the significant judgements in the application of the new standard.

Interim disclosures

The ED proposes that an entity should provide specific revenue recognition disclosures in interim financial statements. The Boards decided to require disclosure of the following information in interim financial statements:

- a disaggregation of revenue;
- a tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period;
- an analysis of remaining performance obligations;
- information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period; and
- a tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer.

Transition

An entity would be required to apply the proposed revenue standard retrospectively, subject to the following optional reliefs:

- not restating for contracts that begin and end within the same annual reporting period and were completed before the date of initial application;
- using the final transaction price for contracts with variable consideration which were completed before the date of initial application;
- not requiring the onerous test to be performed before the date of initial application unless an onerous contract liability was recognised previously; and
- not requiring disclosure for prior periods of the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue.

If an entity applies the standard retrospectively subject to any of the above reliefs, it would be required to state which reliefs have been taken and provide a qualitative assessment of the likely effect of applying those reliefs.

An entity would apply any expedients consistently to all reporting periods presented. In addition, an entity would disclose the expedients that have been used and, to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.

Observation

The revised ED's provision of some relief from full retrospective application of the new standard will alleviate some concerns about the cost and effort to apply the proposals retrospectively. However, even with the availability of the reliefs, the adoption of the final standard may require a significant amount of cost and effort.

- Entities may need to review their internal information systems to determine if there is a need to modify their internal systems, controls and processes to gather necessary information to comply with the new disclosure requirements and changes in revenue recognition and cost capitalisation in a consistent manner.
- Entities may need to assess the implications of any potential changes to the presentation of financial results on key performance indicators (e.g., gross margin ratios), covenants, and existing contracts (e.g., remuneration agreements). Entities may also need to consider if there are any further tax implications from the revised proposals. Stakeholder education may be necessary to explain any potential changes to the financial statements.
- Entities will need to consider the effects of the revised proposals as they negotiate new contractual arrangements and modify existing agreements.
- The application of various aspects of the revised proposals will require judgement and estimation.

Effective date and early application

The Boards will not make a final decision on the effective date of the new standard until they complete their deliberations on the revised proposals in 2012. However, the Boards tentatively decided that the effective date of the proposed standard would not be earlier than for annual reporting periods beginning on or after 1 January 2015, with the IASB permitting early application. First-time adopters of IFRSs would also be permitted to apply the revenue recognition standard early.

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