

Revenue Recognition

In November 2011, the IASB (and FASB) issued a revised ED for revenue recognition (and some related costs) from contracts with customers (ED/2011/06). If adopted, the proposals would replace IAS 18 Revenue, IAS 11 Construction Contracts and related Interpretations. The ED is open for comment until 13 March 2012.

The core principle is that an entity should 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 in exchange for those goods or services.

The revised proposals reflect comments and feedback received on the 2010 exposure draft. In particular the boards responded to concerns relating to identifying when control of a service or a partly completed asset transfers to a customer and that the criteria proposed in 2010 would result in a company identifying too many separate performance obligations, which would not necessarily reflect the economics of the contract. In producing the 2011 ED the boards have also:

- added guidance on transfers over time;
- simplified the proposals on warranties;
- simplified how an entity would determine a transaction price;
- modified the scope of the onerous test to apply to long-term services only; and
- added a practical expedient that permits an entity to recognise as an expense costs of obtaining a contract (if one year or less)

The 2011 ED identifies five steps that an entity should apply to achieve the core principle.

- 1 Identify the contract with the customer.
The provisions are generally applied to each individual contract with a party. If certain criteria are met, separate contracts with the same party entered into at or near the same time must be combined under the ED. The ED also addresses contract modifications.
- 2 Identify the separate performance obligations in the contract.
Each promised good or service is treated as a separate performance obligation if it is “distinct”, ie it is regularly sold separately by the entity, or the customer benefits from the good or service on its own or together with resources that are readily available to the customer. A bundle of goods or services should be combined and treated as a single performance obligation if they are both:
 - highly interrelated and the entity provides a significant service of integrating the goods or services into the combined item and
 - significantly modified or customised to fulfil the contract.
- 3 Determine the transaction price.
Which is the amount of consideration to which an entity expects to be entitled in exchange for transferring the promised goods or services. It does not reflect the effects of the customer’s credit risks. Adjustments for credit risk would be presented in profit or loss as a separate line item adjacent to revenue. The ED contains guidance for variable consideration, the time value of money, non-cash consideration, and consideration payable to a customer.
- 4 Allocate the transaction price to the separate performance obligations in the contract.
Allocate using a relative stand-alone selling price basis for each separate performance obligation. The best evidence is based on the observable price at which the good or service can be sold separately. If an observable price is not available, the stand-alone price should be estimated
- 5 Recognise revenue when (or as) the entity satisfies a performance obligation.

This occurs when (or as) the entity transfers control of a promised good or service to a customer. The ED specifies two criteria of which at least one must be met to evidence the transfer of control (and the recognition of revenue) over time.

The ED is available here

<http://www.ifrs.org/Current+Projects/IASB+Projects/Revenue+Recognition/EDNov11/ED.htm>