Hong Kong Institute of
Certified Public Accountants
香港會計師公會

16 November 2011

To: Members of the Hong Kong Institute of CPAs
All other interested parties

INVITATION TO COMMENT ON IASB EXPOSURE DRAFT OF *REVENUE FROM CONTRACTS WITH CUSTOMERS*

Comments to be received by 20 February 2012

The Hong Kong Institute of Certified Public Accountants' (Institute) Financial Reporting Standards Committee (FRSC) is seeking comments on the IASB Exposure Draft which has been posted on the Institute's website at:
http://www.hkicpa.org.hk/en/standards-and-regulations/standards/financial-reporting/exposure-drafts/.

The proposal would improve and converge the financial reporting requirements of International Financial Reporting Standards (IFRSs) and US General Accepted Accounting Principles (GAAP) for revenue (and some related costs) from contracts with customers.

The IASB and the US Financial Accounting Standards Board (FASB) decided to re-expose the proposals because of the importance of the financial reporting of revenue to all entities and the boards' desire to avoid unintended consequences arising from the final standard. The proposed standard would improve IFRSs and US GAAP by:

- providing a more robust framework for addressing revenue recognition issues;
- removing inconsistencies from existing requirements;
- improving comparability across companies, industries and capital markets;
- providing more useful information to users of financial statements through improved disclosure requirements; and
- simplifying the preparation of financial statements by streamlining the volume of accounting guidance.

The core principle of this revised proposed standard is the same as that of the 2010 exposure draft: that an entity would recognise revenue from contracts with customers when it transfers promised goods or services to the customer. The amount of revenue recognised would be the amount of consideration promised by the customer in exchange for the transferred goods or services. However, in response to feedback received on the 2010 exposure draft and extensive outreach activities, the boards further refined their original proposals. In particular they:

- added guidance on how to determine when a good or service is transferred over time;
- simplified the proposals on warranties;
- simplified how an entity would determine a transaction price (including collectibility, time value of money, and variable consideration);
- modified the scope of the onerous test to apply to long-term services only;
- added a practical expedient that permits an entity to recognise as an expense costs of obtaining a contract (if one year or less); and
- provided exemption from some disclosures for non-public entities that apply US GAAP.

If adopted, the proposed standard would replace IAS 18 *Revenue*, IAS 11 *Construction Contracts* and related Interpretations.

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--- A summary prepared by the IASB on the Exposure Draft is set out in the attached Appendix.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the IASB Exposure Draft to be considered, they are requested to be received by the Institute on or before **20 February 2012**.

Comments may be sent by mail, fax or e-mail to:

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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

Snapshot: Revenue from Contracts with Customers

This snapshot introduces the revised exposure draft *Revenue from Contracts with Customers*. It provides an overview of the main proposals that were developed jointly by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB). It also summarises the feedback received on the 2010 exposure draft.

Project objectives:	To improve financial reporting by creating a common revenue recognition standard for IFRSs and US GAAP that clarifies the principles for recognising revenue and that can be applied consistently across various transactions, industries and capital markets.
Project stage:	The boards are inviting comment on their revised proposals for a new revenue recognition standard. The revised exposure draft includes clarifications, simplifications and other revisions that the boards have made to their proposals on the basis of feedback received on their previous exposure draft, which was published in June 2010.
Comment deadline:	13 March 2012
Next steps:	The boards will undertake outreach activities during the comment period to obtain additional feedback that will be considered when they finalise the standard. The boards plan to issue the revenue standard in 2012.

IFRS™

Why change the requirements for recognising revenue?

Users of financial statements rely on information about revenue to assess a company's performance and prospects, and to compare that company with other companies. However, existing revenue requirements in IFRSs and US GAAP make it difficult for users to understand and compare revenues.

There are inconsistencies and weaknesses in existing standards

- In IFRSs, diverse revenue recognition practices have arisen because IAS 18 *Revenue* and IAS 11 *Construction Contracts* contain limited guidance on some topics and the guidance that is provided can be difficult to apply to complex transactions. Some companies also supplement the limited guidance in IAS 18 by selectively applying US GAAP.
- In US GAAP, there are numerous industry and transaction specific requirements that can result in economically similar transactions being accounted for differently.

Disclosure requirements are inadequate

The disclosure requirements in IFRSs and US GAAP often result in information that is inadequate for users to understand a company's revenues and the judgements and estimates made by the company in recognising those revenues. In particular, users are concerned that the revenue information that is disclosed in the financial statements is often formulaic (or 'boilerplate') in nature.

What are the boards proposing?

To address those deficiencies in their existing standards, the boards have developed a draft standard that provides a robust and comprehensive framework for the recognition, measurement and disclosure of revenue and some contract costs.

If adopted, the standard would:

- improve comparability of revenue recognition practices across companies, industries and capital markets;
- simplify the preparation of financial statements by reducing the number of requirements to which a company must refer;
- reduce the need for interpretative guidance to be developed on a case-by-case basis to address emerging revenue recognition issues; and
- provide more useful information to users of financial statements through improved disclosure requirements.

For IFRSs, the standard would replace IAS 18, IAS 11 and various Interpretations.

Why not amend IASs 18 and 11?

Making amendments to IASs 18 and 11 would not resolve the fundamental weakness in those standards—ie that a company could recognise revenue in different ways depending on which standard it applies. The effect of such inconsistency is pronounced because IFRSs do not clearly distinguish between goods and services and, consequently, it can be difficult for a company to determine whether to account for some transactions in accordance with IAS 18 or IAS 11.

IFRIC 15 *Agreements for the Construction of Real Estate* was developed to clarify the application of those standards for one type of transaction. However, it does not resolve issues of scope more generally and it does not address the inconsistencies in the revenue recognition principles in IASs 18 and 11.

Amending IASs 18 and 11 would also not achieve convergence between IFRSs and US GAAP in the recognition of revenue.

A framework for recognising revenue

The exposure draft addresses when a company recognises revenue and how much revenue should be recognised.

The core principle of the exposure draft is that a company should recognise revenue to depict the transfer of promised goods or services to a customer in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services.

To recognise revenue, a company would apply the following five steps:

Step 1

Identify the contract(s) with the customer

A company would apply the proposals to the enforceable rights and obligations in each contract that has been agreed with a customer.

However, in some cases, a company would combine contracts and account for them as one contract.

Step 2

Identify the separate performance obligations in the contract

A contract includes promises to transfer goods or services to a customer. Those promises are called *performance obligations*. A company would account separately for performance obligations to transfer goods or services that are distinct.

A good or service is distinct if it is regularly sold separately by the company or if it provides a benefit to the customer. However, a good or service is not distinct if the good or service is bundled with other goods or services in the contract that are highly interrelated and the company promises to integrate those goods or services into an item(s) for which the customer contracted.

Step 3

Determine the transaction price

The transaction price is the amount of consideration (ie payment) to which a company expects to be entitled in exchange for transferring promised goods or services to a customer.

Usually, the transaction price would be a fixed amount of customer consideration. Sometimes, the transaction price would include estimates of consideration that is variable or is in a form other than cash. The transaction price would also be adjusted for the effects of the time value of money (if significant to the contract) and for any consideration payable to the customer.

The effects of credit risk (collectibility) would not be reflected in the transaction price. Instead, those effects would be presented as a separate line item adjacent to revenue.

Step 4

Allocate the transaction price

A company would typically allocate the transaction price to each separate performance obligation on the basis of the relative stand-alone selling price of each distinct good or service. If a stand-alone selling price is not observable, a company would estimate it (possibly using a residual estimation approach).

Sometimes, the transaction price would include a discount or a contingent amount of consideration that relates entirely to one of the performance obligations in a contract. The proposals specify when a company should allocate the discount or contingent consideration to one performance obligation rather than to all performance obligations in the contract.

Step 5

Recognise revenue when a performance obligation is satisfied

A company would recognise revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). The amount of revenue a company recognises would be the amount allocated to the satisified performance obligation.

A performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer). For performance obligations satisfied over time, a company would select an appropriate measure of progress to determine how much revenue should be recognised as the performance obligation is satisfied.

The proposed requirements would limit the cumulative amount of revenue a company recognises to date to the amount to which the company is reasonably assured to be entitled.

Other proposals

Onerous performance obligations

The boards propose that a company should recognise a liability for performance obligations that are onerous. A performance obligation is onerous if the lowest cost of settling the performance obligation exceeds the amount of the transaction price allocated to that performance obligation.

The scope of that onerous test is limited to performance obligations that are satisfied over time, and over a period of time greater than one year (for example, a contract to construct a building that will take 3 years to complete).

If a company promises to transfer goods to a customer at a loss, it would test its inventory for impairment in accordance with existing standards on inventory.

Contract costs

The boards propose requirements for accounting for some costs to obtain or fulfil a contract with a customer.

A company would recognise an asset for the incremental costs of obtaining a contract, if those costs are expected to be recovered.

For costs to fulfil a contract that are not within the scope of other standards, a company would recognise an asset for those costs if:

- the costs relate directly to a contract (or a specific anticipated contract);
- the costs generate or enhance resources of the company that would be used in satisfying performance obligations in the future; and
- the costs are expected to be recovered.

Disclosure

To help users of financial statements better understand the nature, amount, timing and uncertainty of revenue and cash flow from contracts with customers, the boards propose that a company should disclose qualitative and quantitative information about:

- its contracts with customers;
- the significant judgements, and changes in judgements, made in applying the proposed requirements to those contracts; and
- any assets recognised from the costs to obtain or fulfil the contract with the customer.

In addition, the boards propose that some specified information should also be disclosed in a company's interim financial reports.

What has changed from the 2010 exposure draft?

Feedback from the 2010 exposure draft indicated broad support for the core principle and the steps to apply that principle. Hence, these remain largely unchanged. However, the boards have clarified and simplified the proposals in a number of areas on the basis of feedback received.

The main changes from the 2010 exposure draft include:

- amending the principle for identifying separate performance obligations in a contract;
- adding criteria to determine when a performance obligation is satisfied over time and, hence, when revenue is recognised over time;
- simplifying the measurement of the transaction price;
- aligning the accounting for product warranties more closely with existing requirements;
- limiting the scope of the onerous test;
- adding practical expedients for retrospective application of the proposals; and
- specifying the disclosures required for interim financial reports.

Why are the boards re-exposing their proposals?

The boards decided to expose the revised proposals because of the importance of revenue in financial statements, even though their due process procedures did not require them to re-expose.

The boards invite comment on whether the proposals:

- are clear and complete
- can be applied in a way that reflects the economic substance of a company's contracts with customers
- produce unintended consequences.

Comments are also invited on some of the more substantive changes to the 2010 exposure draft.

What would change from existing requirements?

For many contracts, such as straightforward retail transactions, the proposals would have little, if any, effect on the amount and timing of revenue recognition.

For other contracts, such as long-term service contracts and multiple element arrangements, the proposals *could* result in changes to the amount and timing of the revenue recognised by a company. The nature and extent of the changes will vary between companies and industries because of the diversity in existing revenue recognition practices.

However, those changes are necessary in order to move from revenue recognition requirements that have weaknesses and inconsistencies to a comprehensive framework for revenue recognition that will result in economically similar transactions being accounted for on a consistent basis across different companies, industries and capital markets.

APPENDIX

Remove inconsistencies	Current practice	Intended outcome
	Incidental obligations and sales incentives Some companies may not separately recognise revenue for the transfer to the customer of goods or services that are considered to be sales incentives or otherwise incidental or ancillary to the other promised goods or services in the contract. That practice can result in a company recognising all of the transaction price as revenue even though it has remaining performance obligations to satisfy.	A company would assess if the promised goods or services arising from incidental obligations and sales incentives are goods or services that are distinct. If they are distinct, the company would recognise revenue as each distinct good or service is transferred to the customer.
	Contingent revenue cap Some practices for allocating the transaction price limit the amount of consideration allocated to a satisfied performance obligation to the amount that is not contingent on the satisfaction of performance obligations in the future. For example, that practice is commonly used to account for telecommunications contracts that bundle the sale of a mobile phone with the provision of network services for a specified period (often for one or two years).	A company would allocate the transaction price—which would be any amount that the customer pays on entering into the contract and the monthly payments for the network services—to the mobile phone and the network services on the basis of the relative stand-alone selling prices of each item. The proposed requirements would not permit the transaction price to be allocated on a basis that is consistent with the contingent revenue cap.
	No observable selling price Some practices may preclude a company from recognising revenue on the transfer of a good or service to a customer if there is no observable evidence of the stand-alone selling prices of each of the goods or services promised in the contract. For example, there are often no observable prices for upgrades and additional functionality for computer software and consumer electronics. That practice can result in the deferral of revenue recognition because revenue may not be recognised when some goods or services are transferred to the customer.	If observable prices of the promised goods or services are not available, a company would allocate the transaction price on the basis of estimated stand-alone selling prices of those goods or services. The company would recognise revenue as each distinct good or service is transferred to the customer .

What would change from existing requirements? continued...

Remove weaknesses

Current practice	Intended outcome
Timing of revenue recognition Due to a lack of clear and comprehensive guidance, there is some diversity in determining whether a company should recognise revenue for some goods or services at a point in time or over time.	A company would be able to recognise revenue over time only if the criteria specified in the proposed requirements are met. In all other cases, a company would recognise revenue at the point in time when the customer obtains control of the promised good or service.
Estimates of variable consideration Existing requirements do not include detailed guidance for measuring the amount of revenue that should be recognised when consideration is variable.	If the consideration is variable, a company would estimate either the expected value or most likely amount to determine the transaction price, depending on which method would better predict the amount of consideration to which the company will be entitled.
Time value of money Some companies may not consider the effects of the time value of money in determining the amount of revenue to recognise.	A company would be required to consider the effect of the time value of money when determining the transaction price (and thus the amount of revenue to recognise). This may affect long-term contracts in which payment by the customer and performance by the company occur at significantly different times.
Disclosure Current disclosures about revenue are inadequate and lack cohesion with the disclosure of other items in the financial statements. For example, many users have said that companies present revenue in isolation which means that users cannot relate revenue to the company's financial position.	The exposure draft proposes a comprehensive set of disclosure requirements that would require a company to disclose qualitative and quantitative information about its contracts with customers to help users of the financial statements to understand the nature, amount, timing and uncertainty of revenue. Some of the information would also be required to be disclosed in interim financial reports.

Feedback received on the 2010 exposure draft

The boards received extensive feedback on the 2010 exposure draft through comment letters and supplemented by outreach activities.

Nearly 1000 comment letters were received in response to the 2010 exposure draft and IASB members and staff discussed the proposals at more than 200 meetings or events on six continents, including with:

- preparers from various industries (eg aerospace and defence, construction, consulting, financial services, entertainment, pharmaceutical, real estate, software, telecommunications and transport);
- investors, analysts and other users of financial statements;
- accounting firms;
- securities regulators; and
- national standard setters.

Those outreach activities included:

- round-table discussions in the United Kingdom, Malaysia and the United States;
- conferences, workshops, discussion forums and field visits; and
- webcasts and podcasts.

The feedback indicated general support for the core principle proposed in the 2010 exposure draft. However, respondents asked the boards to clarify and simplify the application of some of the proposals related to the core principle.

The following pages outline the more significant matters raised and how the boards have responded:

- control
- distinct goods or services
- collectibility
- constraint on revenue recognition
- onerous performance obligations
- disclosure
- other matters.

Control

The 2010 exposure draft proposed that a company should recognise revenue when it satisfies a performance obligation by transferring a good or service to a customer.

A good or service is transferred to a customer when the customer obtains control of that good or service.

The exposure draft proposed some indicators to help a company to assess whether a customer has obtained control of a good or service.

Feedback

Many respondents agreed with using the notion of control to determine when a good or service is transferred to a customer. However, many respondents indicated that, although identifying when control of a good transfers to a customer is intuitive, identifying when control of a service or a partly completed asset transfers to a customer is less so.

Some respondents questioned whether, instead of control, a "risks and rewards of ownership" test should apply to determine when a good or service transfers to a customer. Some other respondents suggested that the risks and rewards of ownership could be used as an indicator of whether the customer has obtained control of a good or service. Some respondents also suggested that the fact that a good has a customer-specific design or function does not necessarily indicate whether the customer has obtained control of the good as it is being constructed. Other factors, such as whether the company has a right to payment for the work it has performed to date, could be more relevant to making that determination.

The boards' response

The boards decided to retain the notion of control to determine when a good or service is transferred to a customer. The boards acknowledged those concerns about applying control to some transactions and they decided to supplement the notion of control with criteria that would focus on when a performance obligation is satisfied, rather than the nature or the type of the performance obligation (for example, criteria for the transfer of a good or the transfer of a service). Consequently, the revised exposure draft specifies criteria to determine when the transfer of a good or service occurs over time and, thus, when a performance obligation is satisfied over time.

Based on the feedback received, the boards decided to add risks and rewards of ownership as an indicator of when control of a good or service is transferred. The boards also eliminated customer-specific design or function as an indicator of control for the reasons identified by the respondents.

Distinct goods or services

The 2010 exposure draft proposed that a company would account for a good or service as a separate performance obligation if it is distinct. A good or service is distinct if:

(a) it is sold separately by the company or another company; or

(b) it could be sold separately because the good or service has a distinct function and a distinct profit margin.

Feedback

Many respondents commented that the proposed criteria would result in a company identifying too many separate performance obligations, which would not necessarily reflect the economics of the contract. That is because the experience of other companies, including companies that operate in different markets or jurisdictions, may not be relevant for determining whether each of the promised goods or services in a contract is distinct. Furthermore, respondents asked the boards to clarify the meaning of 'distinct profit margin'.

Respondents were also concerned that applying the criteria to construction contracts could result in separate performance obligations being identified for each type of construction material and construction service that is provided to the customer, even though those goods or services are highly interrelated and the company is integrating those materials and services to construct an asset for the customer.

The boards' response

Based on that feedback, the boards revised the criteria for identifying separate performance obligations by:

- specifying when a bundle of highly interrelated goods or services should be accounted for as a single performance obligation;
- requiring a company to consider only whether it sells the good or service separately, rather than considering if other companies sell the good or service separately; and
- eliminating the 'distinct profit margin' criterion.

Collectibility

The 2010 exposure draft proposed that a company should recognise revenue at the amount of consideration that the company expects to receive from the customer. Thus, when determining the transaction price, the company should consider the effect of the customer's credit risk.

Feedback

Many respondents were concerned that the amount of revenue recognised in accordance with the proposals may not reflect the amount invoiced to the customer or the amount of consideration received from the customer. That would be a significant change from current practice. Furthermore, many users of financial statements would prefer to have information on contractual revenue reported separately from credit losses from contracts with customers.

Many companies explained that the proposal may be difficult to apply in practice. That is because credit risk is often assessed at a portfolio level and managed separately from the sales function. Those respondents interpreted the exposure draft as proposing that a company would need to make a customer-specific credit adjustment to each contract. That could require extensive systems changes.

The boards' response

The boards acknowledged those concerns and, consequently, they decided that a company should recognise revenue at the amount of consideration to which the company expects to be *entitled*. As a result, a company would exclude expectations of collectibility when determining the amount of the transaction price (and thus the amount that is recognised as revenue).

To provide greater transparency on the relationship between revenue and customer credit risk, the boards propose that a company should present any impairment losses relating to contracts with customers (which would be recognised and measured in accordance with the financial instruments standards) as a separate line item adjacent to the revenue line. That presentation would enable users of financial statements to easily compare a company's revenues (at the stated contractual amount) and the reductions of revenue arising from customer credit risks.

Constraint on revenue recognition

The 2010 exposure draft proposed that a company should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. The transaction price can be reasonably estimated if the company has experience with similar types of contracts and the company's experience is relevant to the contract.

Feedback

Most respondents supported a constraint on revenue recognition. However, some commented that constraining the estimate of the transaction price may result in the recognition of revenue that does not depict the transfer of goods or services. That is because the company would be required to allocate the portion of the transaction price that can be reasonably estimated to all of the separate performance obligations in the contract.

The boards' response

The boards acknowledged that constraining the transaction price could produce anomalous outcomes in some situations. Consequently, the boards decided that the constraint should apply when the consideration in a contract is variable and only to the cumulative amount of revenue recognised rather than to the estimate of the transaction price that is allocated to the separate performance obligations in the contract.

In addition, the boards also decided to use the term 'reasonably assured' rather than 'reasonably estimated' to describe the constraint. Thus, when the consideration is variable, the cumulative amount of revenue recognised would be the amount of consideration to which the company is reasonably assured to be entitled.

The boards clarified that the reasonably assured constraint is not a quantitative probability threshold. Instead, the constraint considers the quality of the information that the company uses to estimate the amount of variable consideration to which it is entitled.

Onerous performance obligations

The 2010 exposure draft proposed that a company should recognise a liability for an onerous performance obligation. A performance obligation is onerous when the costs that relate directly to satisfying the performance obligation exceed the transaction price allocated to it.

Feedback

Respondents commented that recognising a loss for an onerous performance obligation may not always provide users of financial statements with useful information. That is because a performance obligation could be assessed as being onerous even though the benefits to the company of entering into the contract with a customer are greater than the costs of fulfilling that contract. That may occur because the contract as a whole is expected to be profitable or because the contract is priced and profitability assessed at a level higher than the contract. For example, in the airline industry, some seats on a single flight may be sold at a deep discount whereas other seats will be priced to ensure that the flight is profitable overall. Several respondents were concerned that recognising a loss for an onerous performance obligation in those cases may not accurately portray the economics of the transaction.

The boards' response

On the basis of that feedback, the boards considered how to refine the application of the onerous test. The boards decided that the onerous test should continue to apply at the level of a performance obligation because that is consistent with the proposed requirements for recognising revenue. To address respondents' concerns, the boards instead propose to modify the scope of the onerous test by:

(a) limiting it to performance obligations satisfied over time when those performance obligations are expected to be satisfied over a period of time greater than one year.

(b) clarifying that a performance obligation is onerous when the lowest cost of settling the performance obligation (which is the lower of the costs that relate directly to satisfying the performance obligation and the amount that the company would pay to exit the performance obligation) exceeds the transaction price allocated to that performance obligation.

Disclosure

The 2010 exposure draft proposed that a company should disclose qualitative and quantitative information about its contracts with customers and the significant judgements, and changes in judgements, made in accounting for those contracts.

Feedback

Some respondents (mostly preparers and auditors) observed that the proposed disclosure requirements may result in voluminous disclosures that may not be justified on a cost-benefit basis. However, others (mostly users of financial statements) observed that the proposed disclosure requirements would vastly improve existing revenue disclosures because they would help users understand the risks associated with future revenues and the timing and amount of revenue to be recognised from existing contracts.

The boards' response

The boards acknowledge that the volume of disclosure would increase compared to existing disclosure requirements, but that increase in disclosure is necessary to improve the usefulness of existing revenue disclosures, which users regard as having substantial shortcomings. Consequently, the boards affirmed the disclosure requirements proposed in the 2010 exposure draft.

Some of the concerns about excessive disclosure seem to be based on inferences about the length of the list of the proposed disclosures. That list of disclosures is a necessary consequence of the fact that the proposed revenue standard would apply to companies operating in a wide array of industries and, as such, some of the proposed disclosure requirements would be relevant for some companies and industries, but not for others. For that reason, the proposals emphasise that companies should not consider the proposed disclosures to be a checklist of minimum disclosure. A company would only be required to disclose information that is material.

Other matters

Combining and modifying contracts

The boards proposed in the 2010 exposure draft that the principle of 'price independence' should determine when to combine or segment a contract and when to account for a contract modification as a separate contract.

Many respondents suggested the principle of 'price independence' was too broad and would result in a company combining too many contracts and accounting for too many contract modifications on a cumulative catch-up basis.

The boards agreed with those comments. They eliminated 'price independence' and the proposals clarify when a company would combine contracts and how a company would account for a contract modification. Consequently, fewer contract modifications would be accounted for on a cumulative catch-up basis. In addition, the boards eliminated the proposal to segment a contract because it is unnecessary given the requirement to identify separate performance obligations.

Variable consideration

In the 2010 exposure draft, the boards proposed using probability-weighted measurement techniques to determine the transaction price when the customer promises an amount of variable consideration.

Most respondents commented that a probability-weighted method would be complex to apply and would not always generate information that is meaningful because the estimated transaction price could be an amount of consideration that is not a possible outcome under the contract. Instead, respondents suggested that the transaction price should be determined by using management's best estimate.

The boards agreed that a probability-weighted estimate may not be appropriate in all situations. However, they disagreed with using management's best estimate because it lacks a clear basis for estimation. Instead, the boards propose that a company should estimate variable consideration at either the expected value amount (ie probability-weighted amount) or the most likely amount, depending on which method better predicts the amount of consideration to which it will be entitled.

Warranties

The boards proposed in the 2010 exposure draft that the accounting for warranties should distinguish between coverage for latent defects in the product at the time of sale (an unsatisfied performance obligation) and coverage for faults that arise within a specified period after sale (a separate performance obligation). Either type of warranty would result in a company deferring an amount of revenue.

However, almost all respondents disagreed with accounting for warranties on the basis of the nature of protection promised to the customer because of the difficulties in determining when a fault has arisen in a product.

Consequently, the boards propose that a warranty should be accounted for as a separate performance obligation if a customer could purchase the warranty separately from the company or if the warranty provides a service in addition to the assurance that the company's past performance was as specified in the contract. A company would account for other types of warranties in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Time value of money

In the 2010 exposure draft, the boards proposed that the amount of the transaction price should be adjusted to reflect the time value of money if the contract includes a material financing component (whether explicitly or implicitly).

Respondents questioned whether the benefits of accounting for the time value of money would justify the complexity involved, especially because a company may need to calculate the effect of the time value of money to determine whether those effects would be material either to an individual contract or to the company if it has a portfolio of similar contracts. Respondents also questioned whether a company would always need to account for the effects of the time value of money merely because payment from the customer is due either significantly before or after the transfer of goods or services to that customer.

The boards clarified that the determination of the transaction price should reflect the time value of money if the contract includes a financing component that is significant to the contract. The exposure draft also identifies various factors that a company should consider when assessing whether a financing component is significant to the contract. To ease the application of the proposed requirements, the boards propose that a company need not account for the effects of the time value of money in a contract if, at contract inception, the period between payment and transfer of the promised goods or services is expected to be one year or less.

Retrospective application

The boards proposed in the 2010 exposure draft that a company would apply the proposed requirements retrospectively.

Although many respondents acknowledged that retrospective application would provide users with useful trend information about revenue, many were also concerned that the benefits of that trend information would not be sufficient to justify retrospective application in the light of the substantial difficulties and costs that companies might face in applying the proposed requirements retrospectively to all their contracts.

The boards decided that retrospective application would ensure that all contracts with customers are recognised and measured consistently in the current period and in comparative periods. To ease the burden of retrospective application, the boards have proposed some reliefs that companies can elect to use when they initially apply the standard. The boards have also clarified that, in setting the effective date, they will ensure that the start of the earliest comparative period presented will be a few months after the standard is issued (assuming two comparative periods are presented).

Project timeline

2008 — December 2008

Discussion paper

Preliminary Views on Revenue Recognition in Contracts with Customers

Over 200 comment letters received

2010 — June 2010

Exposure draft

Revenue from Contracts with Customers

Nearly 1000 comment letters received and extensive outreach conducted on the proposals

2011 — November 2011

Revised exposure draft

Re-exposure of *Revenue from Contracts with Customers*

Comment period closes 13 March 2012

2012 — H2 2012

Expected IFRS

IFRS X *Revenue from Contracts with Customers*

Effective date no earlier than 1 January 2015

2 years after effective date — TBD

Post implementation review

Effective date

The boards' objective in proposing an effective date for the standard of no earlier than annual reporting periods beginning on or after 1 January 2015 is to ensure that, for a company providing two years of comparative annual financial information (in addition to information for the current year), the standard would be issued before the beginning of the earliest comparative annual period presented.

The boards will reconsider the effective date before they finalise the standard.

What happens now?

The deadline for comments on the revised exposure draft is 13 March 2012.

The boards' main objective in issuing the revised exposure draft is to confirm whether the proposed requirements are clear and whether they can be applied in a way that effectively communicates to users of financial statements the economic substance of a company's contracts with customers. The boards would also like to confirm that the revised proposals do not produce unintended consequences.

In addition, the exposure draft includes questions on the following topics:

- transfer of control of goods or services over time;
- presenting impairment losses arising from uncollectible amounts in a separate line adjacent to revenue;
- constraining revenue to an amount that the company is reasonable assured to be entitled;
- scope of the onerous test; and
- revenue (and cost) disclosures for interim financial reports.

Respondents may choose to answer all or just selected questions. Comment letters will be posted on the boards' websites. The boards will carefully consider all feedback and, as usual, will discuss responses to the proposals in public meetings. The boards plan to issue the final standard in 2012.

Stay informed

The boards will announce on their websites the dates of any meetings at which they will discuss the feedback on the exposure draft.

To stay up to date about the project, view the revised exposure draft, submit your comments or subscribe to an email alert on this project, visit http://go.ifrs.org/revenue+recognition

Notes

Important information

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