DECEMBER 5, 2011

In Focus

FASB and IASB Revised Proposal on Revenue from Contracts with Customers

Overview

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) on November 14, 2011, issued for public comment a revised draft standard to improve and converge the financial reporting requirements of International Financial Reporting Standards (IFRSs) and US General Accepted Accounting Principles (US GAAP) for revenue (and some related costs) from contracts with customers.

Public comments are requested by March 13, 2012. The Boards' first Exposure Draft on revenue recognition was issued in June 2010 (the 2010 Exposure Draft), and generated nearly 1,000 comment letters.

After analyzing the letters and input received during public roundtables and other outreach to stakeholders, the Boards revised many of the 2010 proposals. Given the importance of revenue recognition to financial reporting, the Boards decided to take the extra step of re-exposing the revised proposals for public comment before issuing a final standard.

What are the main proposals in the 2011 Exposure Draft?

The main proposals in the 2011 Exposure Draft are essentially the same as those in the 2010 Exposure Draft. However, the application guidance and descriptions under each main proposal have been modified significantly to address stakeholder concerns.

A company would apply five steps to achieve the core principle of the revenue proposal:

1. Identify the contract with the customer
2. Identify the separate performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price
5. Recognize revenue when a performance obligation Is satisfied.

Why did the Boards undertake a project on revenue recognition?

Revenue is an important number to users of financial reports in assessing a company's performance and prospects. However, revenue recognition requirements in US GAAP differ from those in IFRSs, and many believe both are in need of improvement.

US GAAP has complex, detailed requirements for specific industries or transactions that can result in different accounting for transactions that are economically similar. IFRS has two main revenue recognition standards that have limited implementation guidance and can be difficult to understand and apply. Overall, existing disclosures about revenue have been criticized by financial statement users and regulators who believe they are inadequate.

What have the Boards done to address the issues with existing requirements?

The Boards issued a Discussion Paper in 2008 that presented their initial proposals on when to recognize revenue. The Discussion Paper introduced the concepts of a contract containing performance obligations and that revenue is recognized when an entity satisfies its performance obligations by transferring control of goods or services to a customer. It also introduced a revenue recognition measurement approach based on an allocation of the transaction price.

Respondents to the Discussion Paper generally supported the proposed recognition and measurement principles. However, they expressed concern about the proposals to identify separate performance obligations only on the basis of the timing of transfer of the good or service to the customer. They were also concerned with the proposal on the use of the concept of control to determine when a good or service is transferred. Based on feedback received, the Boards issued the 2010 Exposure Draft in June 2010.

In the 2010 Exposure Draft, the Boards established the core principle that a company should recognize revenue to depict the transfer of promised goods or services to a customer in an amount that reflects the consideration expected to be exchanged for those goods or services.

Respondents to the 2010 Exposure Draft supported this core principle. Most respondents also generally supported the Boards' proposal for a comprehensive revenue recognition model for both US GAAP and IFRS. However, almost all respondents indicated a need for clarification on how the core principle would apply in practice, particularly with respect to the concept of control and its application to service and construction contracts and the principle of distinct goods or services for identifying separate performance obligations in a contract.

The Boards addressed the concerns related to the 2010 Exposure Draft by clarifying the proposals, adding guidance, or simplifying many of the proposals. In some cases, revisions have drawn from concepts in current accounting requirements that are considered to be consistent with the core principle.

What are the most significant changes from the 2010 proposals?

In the 2011 Exposure Draft, the Boards have simplified and clarified many of the principles contained in the 2010 Exposure Draft. Specifically, significant changes in the 2011 Exposure Draft include:

- Adding criteria to help companies determine when a performance obligation is satisfied over time
- Simplifying the criteria for determining whether a good or service is distinct when identifying separate performance obligations
- Eliminating the proposed requirement to adjust the transaction price for collectability, replacing it with a requirement to present an estimate of uncollectible amounts adjacent to revenue
- Removing the proposed requirement to discount the transaction price when the period between payment and transfer of the promised goods or services will be one year or less
- Permitting a company to use a *most likely amount* approach when estimating variable consideration.

Although the revisions to the 2010 Exposure Draft do not necessitate re-exposure for public comment in accordance with the Boards' due process procedures, the Boards 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.

How would the proposed standard apply to private companies and not-for-profit organizations?

As proposed in the 2011 Exposure Draft, most private companies and not-for-profit organizations would be granted exceptions from applying most of the proposed quantitative disclosure requirements. Not-for-profit organizations would be granted an exception from having to apply the onerous performance obligation test for contracts that have been entered into primarily for charitable or social benefit purposes. Finally, the standard would become effective at least one year later for most private companies and not-for-profit organizations.

When would the proposed requirements be effective?

The Boards have acknowledged that companies will need sufficient lead time after the standard is approved to implement its provisions. Therefore, the final standard would be effective no sooner than for annual periods beginning after January 2015; as mentioned above, it would become effective at least one year later for most private companies and not-for-profit organizations.

What are the next steps in the process?

The FASB is hosting a live, free webcast, *IN FOCUS: Understanding the Exposure Draft, Revenue from Contracts with Customers* on Thursday, December 8, 2011, from 10:00 to 11:00 a.m. EST. Participants in the live broadcast will be eligible for up to one hour of CPE credit. More information about the webcast is available at www.fasb.org.

The webcast will feature FASB member Daryl Buck, Prabhakar Kalavacheria, a member of the International Accounting Standards Board (IASB), FASB Project Manager Kenny Bement, and Glenn Brady, senior technical manager with the IASB, discussing the key proposed changes to accounting for revenue recognition from contracts with customers. Topics will include the five steps that are fundamental to the proposed standard, as well as how stakeholders can provide input on the joint proposal. Viewers will have the opportunity to email questions to the speakers during the event.

Stakeholders are requested to provide their written comments on the 2011 Exposure Draft by March 13, 2012.

Between now and the end of the comment period, the Boards will conduct additional outreach with preparers, users, and auditors of financial statements to get their input on the proposals. This will include educational speeches and webcasts, as well as field visits with preparers and auditors in targeted industries.

Outreach to users of financial statements will focus on obtaining feedback on how the proposals would affect the companies they analyze.

The Boards intend to begin redeliberations in the second quarter of 2012. Depending on the feedback received and outcome of redeliberations, a final standard is expected to be issued by the end of 2012.

For more information about the project, please visit the FASB's website at www.fasb.org.

Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, Connecticut 06856-5116
T: 203.847.0700 | F: 203.849.9714