

Revenue from Contracts with Customers

This presentation has been prepared to help stakeholders understand the current status of the Revenue Recognition project of the FASB and the IASB. The views expressed in this presentation are those of the authors and/or presenters. Official positions of the FASB and the IASB are reached only after extensive due process and deliberations.

Project objective

Objective: To develop a single, principle-based revenue standard for US GAAP and IFRSs

- The revenue standard aims to improve accounting for contracts with customers by:
 - Providing a robust framework for addressing revenue issues as they arise
 - Increasing comparability across industries and capital markets
 - Requiring better disclosure

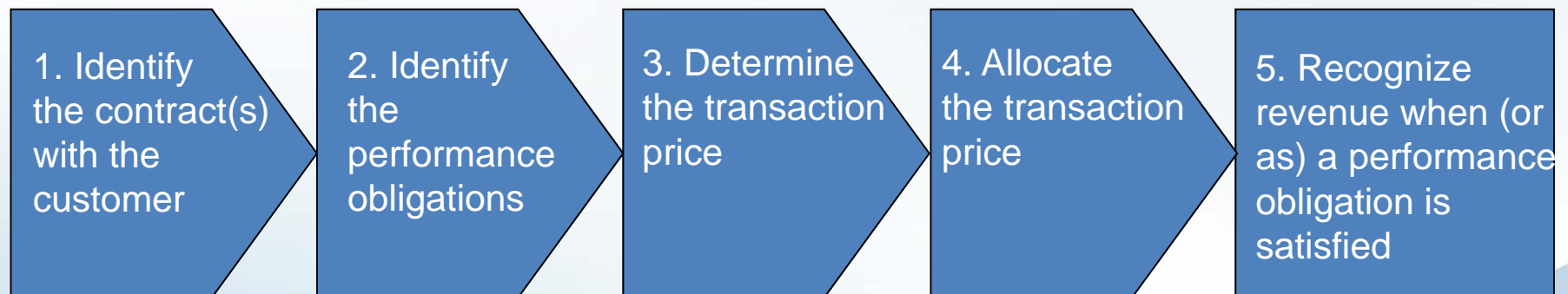
Note: Items in red font throughout this FASB slide deck signify areas in the standard that require significant judgment.

Overview

Core Principle:

Recognize 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

Steps to apply the core principle:



Step 1: Identify the contract(s)

Objective: To identify the bundle of contractual rights and obligations to which an entity would apply the revenue model

Existence of a contract

- Must meet specified criteria to apply the model
 - **Collectibility threshold – *probable*** of collecting consideration to which it will be entitled to

Combine contracts

- Negotiated as a package
- Linked consideration
- Goods or services form one performance obligation

Contract modifications

- Separate contract if add distinct goods/services at standalone selling price
- Prospective if remaining goods/services distinct
- Otherwise, cumulative catch-up

Step 2: Identify the performance obligation(s)

Objective: To identify the promised goods or services that are distinct and should be accounted for separately

Promise to transfer a **distinct good or service**

Customer can benefit from good or service

- On its own
- Together with other readily available goods or services (including goods or services previously acquired from entity)

Promised good or service is separable from other promises

- No significant service of integrating the good or service
- Good or service does not significantly modify or customise another good or service in the contract
- Good or service is not highly dependent on or interrelated with other goods or services

Step 3: Determine transaction price

Objective: To determine amount of consideration to which an entity expects to be entitled in exchange for promised goods or services

Variable consideration

Estimate using:

- Expected value
- Most likely amount but 'Constrained'

Significant financing

Adjust consideration if timing provides customer or entity with significant benefit of financing

Non-cash consideration

Measure at fair value unless cannot be reasonably estimated

Consideration payable to customer

Reduction of the TP unless in exchange for a distinct good or service

Step 3: Constraining variable consideration

Include estimate of variable consideration in the transaction price only if it is *probable* that a significant revenue reversal will not occur when the uncertainty is resolved

- Entity's expectations of revenue reversal assessed using indicators.
 - Factors outside entity's influence (market, 3rd-party actions)
 - Entity's level of experience
 - Length of time before uncertainty resolved

Step 4: Allocate the transaction price

Objective: To allocate to each performance obligation the amount to which the entity expects to be entitled

- **Relative standalone selling price basis**
 - estimate selling prices if not observable
 - residual estimation techniques may be appropriate
- **Discounts and contingent amounts allocated entirely to specific performance obligation if specified criteria met**

Step 5: Recognize revenue

Objective: To recognize revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service

Performance obligations satisfied over time if specified criteria met

Revenue is recognized by measuring progress towards complete satisfaction of the performance obligation

- Clarified units produced or delivered may be a reasonable proxy in some cases
- Clarified input methods may need to be adjusted (eg uninstalled materials)

All other performance obligations satisfied at a point in time

Revenue is recognized at the point in time when the customer obtains control of the promised asset.

Indicators of control include:

- Present right to payment
- Legal title
- Physical possession
- Risks and rewards of ownership
- Customer acceptance

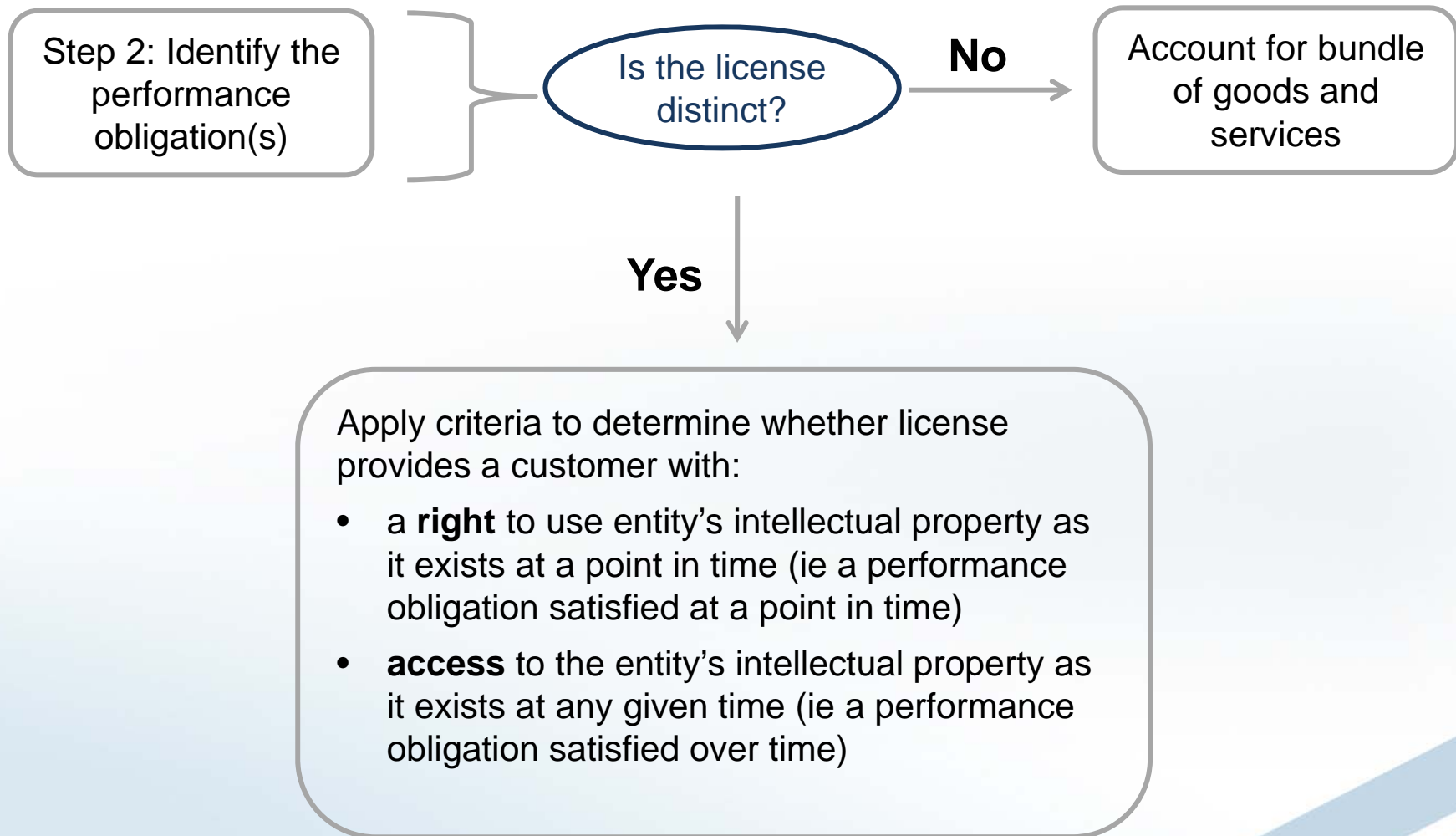
Step 5: Recognize revenue (cont'd)

- **An entity satisfies a performance obligation and recognizes revenue over time if one of the following criteria are met:**
 - Customer receives and consumes the benefits of the entity's performance as the entity performs (e.g. cleaning service)
 - An objective basis for assessing benefit—hypothetically, would another entity need to substantially re-perform the work the entity has completed to date if that other entity were to fulfill the remaining obligation to the customer?
 - Entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced (e.g. a home addition)
 - Entity's performance does not create an asset with an alternative use to the entity and the entity has a right to payment for performance completed to date and it expects to fulfill the contract as promised

Implementation guidance

- Warranties
- **Licenses** (refer next slide)
- Right of return
- Customer options for additional goods or services
- Breakage (customers' unexercised rights)
- Principal versus agent
- Bill and hold arrangements
- Repurchase agreements
- Nonrefundable upfront fees
- Customer acceptance

Implementation guidance: Licenses



Major Industry Changes

- All industries will have to change their processes; major changes are expected in the following industries:
 - Telecommunications (refer to next two slides for example)
 - Real Estate
 - Software
 - Asset Managers

Telecommunications

- Existing US GAAP
 - No consideration allocated to handset because of contingent revenue cap (605-25-30-5)
 - This results in revenue essentially being on cash basis

Telecommunications

- **New Guidance**

- Identify the performance obligations (likely to include the handset and the service)
- The wireless service is a single performance obligation – a series of distinct services that are substantially the same and have the same pattern of transfer
- Allocate the transaction price
 - Is expected to result in a portion of service fees being recognized as revenue when handset is transferred to the customer

Disclosure requirements

Disaggregation of revenue

(See nonpublic entity election on next slide)

- Disaggregate revenue into categories that depict how revenue and cash flows are affected by economic factors
- Explain the relationship with segment disclosures

Information about contract balances

- Opening and closing balances
- Amount of revenue recognized from contract liabilities
- Explanation of significant changes in contract balances

Remaining performance obligations

- Transaction price allocated to remaining performance obligations
- Quantitative or qualitative explanation of when amounts will be recognized as revenue

Interim requirements

- All quantitative disclosures in annual and interim
(Public entities only)

Transition and Effective Date

- For Public Business Entities (ASU 2013-12), which includes certain Not-for-Profit entities and Employee Benefit Plans with securities listed on an exchange or that file or furnish financial statements with the SEC
 - Effective for annual and interim reporting periods beginning after December 15, 2016
 - Early application is not permitted for U.S. GAAP
- For all other entities (nonpublic entities)
 - One year deferral, with earlier application permitted but no earlier than December 15, 2016
- Full retrospective transition method or alternative transition method with a cumulative catch adjustment