Straight away
IFRS bulletin from PwC

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IASB and FASB decide on contract modifications and measures of progress

What's new?

The IASB and FASB ('the boards') met on 18 October 2012 to discuss their joint project on revenue recognition. They reached decisions on contract modifications and measures of progress towards satisfying a performance obligation. The boards' decisions are tentative and subject to change.

Other key issues still to be redeliberated include collectibility, the constraint on recognising revenue from variable consideration, licences, allocation of transaction price, disclosures and transition.

What were the key decisions?

Contract modifications

Revenue from contract modifications that have not been approved by the parties to the contract should not be recognised until the modification is approved. The boards considered providing additional guidance for modifications resulting from 'contract claims'. For example, an entity might seek additional consideration for customer-caused delays, changes, errors in specifications and designs, etc. The boards decided to retain the guidance proposed in the 2011 exposure draft for contract modifications, as they believe it adequately addresses these situations. They agreed, however, to consider including an example that addresses modifications due to contract claims.

The boards also clarified that the accounting for a contract modification that only affects the transaction price should be assessed like any other contract modification. The change in price will then be either accounted for prospectively or on a cumulative catch-up basis depending on whether the remaining performance obligations are distinct.

Measures of progress towards satisfaction of a performance obligation

Revenue is recognised for a performance obligation satisfied over time as the entity progresses toward satisfying that performance obligation. Appropriate methods to measure progress include output methods, such as units produced, and input methods, such as costs incurred. The boards considered whether a practical expedient should be introduced to address situations where a vendor manufactures large volumes of homogeneous goods that also meet the requirements to be accounted for as performance obligations satisfied over time. The boards made no changes to the proposed guidance. They confirmed that an entity should select a method that depicts the transfer of control of the goods and services to the customer, which might be during production rather than upon delivery of the product. This could result in a change in the timing of revenue recognition from today for some entities.

The boards agreed to clarify the guidance for situations where an input method is used, and a customer obtains control of goods significantly in advance of when the entity performs the services related to those goods (that is, uninstalled materials). Feedback received by the boards suggests that this guidance is being interpreted more broadly than they intended. The proposed clarifications should more closely align this guidance with the objective of measuring progress by only including in the measure of progress goods or services that depict transfer to the customer. In certain situations, revenue equal to the cost of the goods should be recognised.

Is convergence achieved?

Convergence is expected for revenue recognition, as the same principles will be applied to similar transactions under both IFRS and US GAAP. Differences might continue to exist to the extent that the guidance requires management to refer to other standards before applying the guidance in the revenue standard.

Who's affected?

The proposal will affect most entities that apply IFRS or US GAAP. Entities that currently follow industry-specific guidance should expect the greatest impact.

What's the proposed effective date?

We anticipate the final standard to have an effective date no earlier than 2015.

What's next?

The boards' timeline indicates issuance of a final standard in the first half of 2013. They are expected to continue their redeliberations over the next few months and perform targeted outreach on some of the more significant changes.