Straight away

IFRS bulletin from PwC

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Revenue recognition – Boards wrap up redeliberations

What's new?

The IASB and FASB (the 'Boards') met to finalise the outstanding issues related to their joint revenue recognition project. Their decisions are tentative and subject to change, but they do not intend to jointly discuss revenue again, and expect to issue a final revenue standard in late 2013 or early 2014.

What are the key decisions?

Constraint on variable consideration including sales- or usage-based royalties

The Boards confirmed that an estimate of variable consideration is included in the transaction price if it is 'highly probable' under IFRS ('probable' under US GAAP) that the amount would not result in a significant revenue reversal. The estimate recorded is a portion of the total variable consideration (that is, a minimum amount) when only that portion is 'highly probable' of not being reversed. Management must reassess this each reporting period.

The Boards reversed an earlier decision by reintroducing an exception for revenue from sales- or usage-based royalties from licences of intellectual property (IP). Royalties from licences of IP are not included in the transaction price until they are no longer variable (that is, when customer's subsequent sales or usages occur). The exception does not apply to other sales- or usage-based royalty arrangements.

Licences

The Boards decided on a model that distinguishes between two types of licences – one that provides a *right to use* IP, and one that provides *access to* IP. The type of licence largely depends on whether the nature of the underlying IP is 'dynamic' or 'static'. A licence of static IP is considered a right to use IP and results in revenue recognition when control has transferred to the licensee and the licence period has begun. A licence that allows the customer to access an entity's IP – as it exists at the time of access – results in revenue recognition over time, because the underlying IP is dynamic.

Licences that meet the following criteria are dynamic:

- The licensor will undertake (either contractually or based on practice) activities that significantly affect the IP to which the customer has rights.
- The activities do not otherwise transfer a good or service to the customer as they occur.
- The rights granted by the licence directly expose the customer to any effects (both positive and negative) of those activities on the IP, and the customer entered into the contract with the intent of being exposed to those effects.

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The Boards emphasised that an entity should apply the five-step model to determine whether the licence is 'distinct' from other goods or services in the arrangement. The boards intend to provide additional implementation guidance for licences in the final standard.

Collectibility

The Boards introduced a collectibility threshold. An entity only applies the revenue guidance to contracts when it is 'probable' the entity will collect the consideration it will be entitled to in exchange for the goods or services it transfers to the customer. This assessment is based on both the customer's ability and intent to pay as amounts become due.

The introduction of the threshold could result in differences between entities reporting under IFRS and those reporting under US GAAP, because 'probable' is defined differently under IFRS and US GAAP.

Am I affected?

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

What's next?

A final standard is expected in late 2013 or early 2014.

The final standard will be effective for the first interim period within annual reporting periods beginning on or after 1 January 2017. Early adoption is permitted.