

IFRS

The Proposed norms for Revenue Recognition - *The Topline Guidance.....by Chirag Juthani*

The bottom-line and the topline are amongst the best indicators of how well an entity is doing. The users of financial statements constantly view these two when making a judgment call about an entity. The international accounting fraternity has decided to converge accounting norms for topline in order to ensure a consistent and global benchmark is adopted when recognizing revenue- measuring the topline.

On June 24th, the FASB and IASB each issued an exposure draft titled Revenue from Contracts with Customers proposing a new revenue recognition model that could fundamentally alter the way entities across a variety of industries recognize revenue. The proposal is an output of the boards' joint efforts to develop a converged revenue recognition standard based on the same principles. A key objective is to increase the consistency of revenue recognition for similar contracts, regardless of industry. The proposed model is a contract-based approach that focuses on the assets and liabilities that are created when an entity enters into and performs under a contract.

The corner stones of the proposed revenue recognition norms vis-à-vis the current are as follows:

Proposed Norms	Current Norms
1. Identify the contract(s) with a customer;	1. Persuasive evidence of arrangement exists
2. Identify the separate performance obligations in the contract;	2. Delivery has occurred or services have been rendered
3. Determine the transaction price;	3. The sellers price is fixed or determinable
4. Allocate the transaction price to the separate performance obligations; and	4. Collectability is reasonably assured
5. Recognize revenue when the entity satisfies each performance obligation.	

Performance obligation refers to an enforceable promise (whether explicit or implicit) in a contract with a customer to transfer a good or service to the customer. The proposed norms identify performance obligation as the unit of accounting for recognizing revenue. Whether a performance obligation qualifies as a unit of accounting would be determined based on either of the following:

1. The entity or another entity sells an identical or similar good or service separately; or
2. The entity can sell the good or service separately because it has a distinct function and a distinct profit margin.

To give an example from our daily life- Departmental stores have a loyalty program in which they give reward points to the customer for every purchase that they make. The customer can collect the reward points and redeem the same for cash or other product purchase. The points provide a material right to customers that they would not receive without entering into a contract. Hence, the entity will be required to recognize the reward points earned by the customer as a separate performance obligation.

There are four indicators to determine whether transfer of control has occurred.

1. Unconditional obligation to pay

If the customer has an unconditional obligation to pay for the good or service, it indicates that the transfer of control has occurred. For example- The entity has completed its performance obligations and the customer is granted a credit period of two months, the customer is said to be unconditionally obligated to pay.

2. Legal title

Once the legal title has been transferred to the customer, it generally indicates transfer of control. In some cases, the entity may retain the title for protective rights. In such case, it may not coincide with transfer of control.

3. Physical possession

The physical possession with the customer is an indicator that transfer of control has occurred. However, in some cases like consignment sale or bill-and-hold arrangements, physical possession may not be relevant.

4. Customer-specific design

When a specific good or service is provided in accordance with the customized requirements of the customer, in such cases the customer may be required to obtain the control of the asset as it is created because the entity might not have any alternative use for the good or service. In such cases, the customer may pay for the work as it is completed.

Transaction price refers to the amount of consideration that an entity receives, or expects to receive, from a customer in exchange for transferring goods or services, excluding amounts collected on behalf of third parties (for example, taxes). When determining the transaction an entity would consider the effects of the following:

1. Collectibility;

Earlier the entity used this to determine whether to recognize revenue. The proposed guidance require the entity to consider collectability in determining how much revenue it should recognize. The credit risk of the customer would be factored in the probability-weighted amount of consideration that the entity expects to receive.

2. The time value of money;

When the contract includes a material financing component, whether explicit or implicit, the entity will have to factor in the time value of money. The effect is material when the payment from the customer is due either significantly before or significantly after the transfer of goods or service to the customer.

3. Noncash consideration;

In many cases, the entity receives noncash consideration. In such a scenario, the entity should measure the noncash consideration at its fair value for determining the transaction price.

4. Consideration payable to the customer

In some scenarios, the entity may grant a discount to the customer, such discount should be reduced from the transaction price. In some cases, the entity may be required to pay for distinct goods or services supplied by the customer. Accordingly, the entity would account for it as if it is a purchase.

As is evident from the discussion, the proposed guidelines are structured to meet the requirements of all industries and would assist in minimizing the differences that exist in the current practices.

Source: KNAV International Accounting & Assurance Practice

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