Assurance and Advisory
Business Services

International Reporting
Financial Standards

EFRAG Advisory Forum on Revenue Recognition

Auditors perspective

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ERNST & YOUNG
Quality In Everything We Do

Current Status

- Allocation process under historical cost accounting based on accruals (matching) concept and prudence (conservatism)
- Framework is focussing on assets/ liabilities approach
- IFRS also promulgates fair value based accounting which results in a mixed model

Conceptual conflicts

- IAS 18 contains two approaches:
  - Critical event approach for sales of goods
  - Performance approach for rendering of services
- IAS 11 only refers to the performance approach for construction contracts
- Lack of guidance how to differentiate between the different methods for revenue recognition
- In addition IAS 41 as well as IAS 39 and other pronouncements are based on a fair value model

Limits of current IAS 18 Guidance

- Lack of guidance to deal with
  - complex transactions undertaken by modern business;
  - industry issues; and
  - presentation issues.
- Further relevant guidance
  - IAS 11 - Construction Contracts
  - IAS 41 - Agriculture
  - IAS 17 - Leases
  - IFRS 4 - Insurance Contracts
  - SIC-13 - JCE - Non-Monetary Contributions by Ventures
  - SIC-31 - Revenue - Barter Transactions Involving Advertising Services
- Guidance is mostly developed to deal with specific issue(s) on piecemeal basis

➡ Different rules exist for different circumstances

Industry Example: Real estate
Application of revenue recognition concept

- Company A constructs a housing estate with a significant number of single houses.
- The houses are designed and built in identical shape but sold separately to single buyers. The houses are not customized for the single buyers.
- It is presumed that at the balance sheet date 10 % of the entire housing estate is completed but nearly 90 % of the houses are already sold.
- Issue: application of IAS 18 versus IAS 11.

Practical Example: Retail
Presentation I

- Company B operates different retail stores in a retail chain.
- Company C's products are placed in the retail store based on a "shop in a shop" concept.
- Products of Company C are presented within special areas.
- Company B has the possibility to refuse products, which are unsuitable for resale in the stores.
- Company C determines the initial quantity of products; subsequent additional order requests shall be the decision of Company B.
- Company B has a general right of return for unsold products.

Practical Example: Retail
Presentation II

- Company C stays legal owner until products are sold to customers.
- Company B jointly advertises for all products sold in its stores.
- Customers pay Company C products together with all further products bought in the retail store and receive one joint bill slip.
- Issue: gross versus net presentation.

Practical Example: Telecom
Multiple-elements contract

- Customer X enters into a wireless line contract with service provider Z.
- The contract has a fixed service life time of 12 month.
- Customer X is required to pay an upfront non-refundable connection fee (which includes the activation of the SIM card).
- Customer X receives a free mobile handheld and pays a monthly flat fee.
- Issue: accounting for the multiple-elements contract by service provider Z.