

In this issue:

Revenue recognition convergence:
Potential challenges in operationalizing the proposed requirements

Tax consequences of the revenue recognition exposure draft

SEC receives comments on incorporating IFRS into the U.S. financial reporting system

IFRS Summit addresses accounting convergence issues

Looking to earn some CPE credits?

IFRS contacts

www.deloitte.com/us/ifrs

IFRS Insights

Achieving a global standard



Revenue recognition convergence: Potential challenges in operationalizing the proposed requirements

On November 14, 2011, the U.S. Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) (collectively, the Boards) jointly issued their revised exposure draft (ED), *Revenue from Contracts with Customers*. The revised ED, if finalized, would provide companies with a single comprehensive model to use in accounting for revenue arising from contracts with customers, and would supersede most current revenue recognition guidance, including industry-specific revenue guidance. The revised ED is the result of redeliberations of the respective Boards' related revenue recognition EDs issued in June 2010 and is subject to a 120-day comment period (comments are due by March 13, 2012) with questions focused on a few areas.

The FASB has tentatively decided that the effective date of the final revenue recognition standard for public companies would not be earlier than annual periods beginning on or after January 1, 2015, with a minimum of a one-year deferral for non-public companies. The deferral of the effective date for non-public companies is currently not

provided by the IASB. The proposed transition guidance requires companies to apply the proposed requirements retrospectively to all periods presented, with certain optional practical expedients. The proposed changes may have some impact on how companies recognize revenue and disclose information regarding revenues from contracts with customers. These proposed changes may create additional challenges related to tax, systems, processes, and internal controls.

Selected key challenges of the revised ED

The proposals in the revised ED would present different levels of complexity for companies in different industries. Examples of some of the key challenges are as follows:

- **Bundled goods and services** — The revised ED proposes identification of separate performance obligations in bundled arrangements with the timing of revenue recognition for separate performance obligations based on when (or as) the performance obligation is satisfied by transferring control of a promised good or service to a customer. The existence of separate performance obligations may require an allocation of the transaction price, and this allocation and the related timing of revenue recognition may not conform to a company's current accounting policies, requiring potential changes to revenue systems and processes.

- **Contract modifications** — The revised ED requires a contract modification to be accounted for as a separate contract if it results in an additional separate performance obligation and is priced commensurate with that additional performance obligation. Otherwise, a company may need to reallocate the transaction price to one or more of the revised set of separate performance obligations which are not already satisfied and update its measure of progress toward completion for performance obligations satisfied over time.
- **Contract costs** — Costs associated with obtaining and fulfilling a contract are capitalized under the revised ED when certain criteria are met, which may require new policies, processes, and data, in order to capture and amortize these capitalizable costs.
- **Warranties** — A warranty would need to be accounted for as a separate performance obligation when it (1) provides a service beyond assuring that a good or service complies with agreed-upon specifications or (2) the customer has the option to purchase the warranty separately.
- **Onerous contracts** — Performance obligations in a contract that are satisfied over a period greater than one year would need to be evaluated each reporting period to determine whether a separate liability should be recognized to cover the lowest cost to satisfy (or settle) these performance obligations. In certain circumstances, applying the onerous test at the performance obligation level, rather than the contract or portfolio level, could result in accruals being required on contracts that are otherwise profitable in total.
- **Other significant changes** — The revised ED includes additional guidance that may represent changes from current practice. For example, credit losses related to bad debts would need to be presented in the income statement as a separate line item adjacent to revenue, as opposed to as an expense. In addition, if the transaction price is subject to variability it may be estimated using a probability weighted approach (expected value) or an approach based on the single most likely amount (whatever is most predictive). Finally, the reasonably assured revenue constraint may be less restrictive than current guidance and may allow for earlier recognition of revenue in certain circumstances.
- **Potential tax implications** — Certain tax implications may also arise from these changes as taxpayers often follow the revenue recognition methods used in maintaining their books and records in the determination of taxable income and transaction tax obligations. The proposed changes may have cash tax implications, may require tax method changes, or give rise to new tax temporary differences that will need to be captured, calculated, and tracked through tax accounting processes and systems. Similar implications may arise in foreign jurisdictions that maintain statutory records. [Please see the following article for more detailed information about the potential tax implications.]
- **Disclosures** — The disclosures required under the revised ED are significant and may require system and process modifications to enable collection and extraction of accurate data needed to satisfy these requirements. Proposed disclosures, among others, include:
 - Disaggregation of revenue
 - Various reconciliation requirements (e.g., contract assets and liabilities, onerous performance obligations, assets recognized from costs to fulfill or obtain a contract with a customer)
 - Nature of performance obligations
 - Significant judgments in the application of the proposed guidance
 - Information about the methods, inputs, and assumptions used to determine the transaction price

Key action steps

Regardless of industry, it is recommended that companies perform an initial assessment of the impact the proposed standard may have on their organization which would include identification of potential accounting changes, the level of effort to implement the required changes, and a roadmap timeline of action steps necessary to achieve these changes before the effective date of the proposed revenue recognition standard. Also, given the retrospective application requirements of the revised ED, companies may wish to have substantial (or all) changes implemented by the beginning of the retrospective application period to permit dual reporting. This objective could significantly narrow the roadmap timeline necessary to implement changes that will be required by the new revenue recognition standard.

Typical action steps that companies may need to consider include:

- Evaluating potential adjustments to revenue recognition policies
- Identifying key new data requirements to perform calculations and compile disclosures
- Determining process modifications to maintain and update new data requirements and calculations, and maintain internal controls
- Implementing necessary system modifications
- Considering tax requirements
- Implementing training and communication programs
- Forecasting and budgeting the implications of these changes and their impact on financial statement ratios and debt covenants
- Evaluating the impact on sales contracts, including how sales personnel are compensated
- Developing program management, resourcing, and related tools for this effort

Companies should carefully consider these potential requirements and plan for these changes in a comprehensive manner.

Tax consequences of the revenue recognition exposure draft

With the recent issuance of the revised ED for revenue recognition, tax departments need to be engaged in the assessment of the accounting impacts to stay ahead of the tax implications.

Federal income tax law provides specific rules with respect to certain types of revenue recognition, such as income from long-term contracts and advance payments for goods and services. While federal income tax law has specific rules, often the rules overlap with a taxpayer's financial reporting methods. In those circumstances, the taxpayer often follows the revenue recognition method it uses in maintaining its books and records as its tax method (e.g., cash basis, U.S. Generally Accepted Accounting Principles (GAAP), and IFRS). As the proposed guidance may change the amount and timing of revenue recognition for those entities that maintain their books and records under U.S. GAAP or IFRS, the revised ED may have cash tax implications or give rise to new book-tax differences that will need to be captured, calculated, and tracked through tax accounting processes and systems.

The general rule under federal tax principles is that income is recognized no later than when received. There are limited exceptions that allow a taxpayer, for example, to defer revenue recognition for certain advance payments from customers. To the extent the revised ED impacts the timing and measurement for these advanced payments, there could be an associated tax impact.

A few of the concepts in the revised ED which may have a cash tax impact or change the measurement of certain temporary differences might include:

- Changes in the timing of book revenue recognition (and contract assets and contract liabilities) that result from when a taxpayer transfers control of goods and services to a customer
- Contracts that include variable or contingent consideration or a significant financing component
- Capitalization of certain costs incurred to obtain or fulfill a contract, some of which may be currently deductible for tax purposes
- The timing of loss deductions related to onerous performance obligations

The tax implications associated with implementing the final standard will be based on an entity's specific facts and circumstances. Thus, it will be important for tax professionals to understand the detailed financial reporting impacts in order to analyze the tax ramifications and facilitate the selection of any alternative tax accounting methods. Before a taxpayer can adopt a new tax accounting method, however, the taxpayer may be required to obtain approval from the taxing authorities. A change in method of tax accounting, including circumstances in which the taxpayer may wish to follow revised book accounting methods, generally requires the consent of the Commissioner of Internal Revenue. Such consent may be automatic or require the issuance of a formal consent letter by the Commissioner, based upon the nature of the specific accounting change request. Similar implications may arise in foreign jurisdictions that maintain statutory accounting records under IFRS or U.S. GAAP.

Additionally, generally speaking, revenue recognition for state income tax purposes follows the federal recognition. For state and local transaction tax purposes, nearly all states prescribe the reporting of gross receipts and sales tax by statute to follow cash or accrual accounting rules. While some states allow a modified approach, all states require consistency in the method used. Timing for transaction tax reporting is important due to statutes of limitation requirements, obtaining contemporaneous exemption certificates, filing/reporting deadlines, and for identifying when the tax liability affixes to a seller's transaction.

Thus, in planning for this future transition, a few tax questions to consider would be:

- Will the potential changes to the timing or measurement of U.S. GAAP or IFRS revenue impact the timing of revenue recognition for federal and state income tax purposes?
- If the financial statement modifications in revenue recognition methods under the revised ED are favorable and permissible for tax purposes, is there a change in method of tax accounting that might require approval from the taxing authorities?
- If the financial statement modifications are unfavorable or impermissible, will tax need to maintain certain legacy U.S. GAAP or IFRS accounting records (that is, records in accordance with the revenue recognition guidance that will be superseded by the revised ED)?
- When the amount of revenue in a contract with multiple performance obligations is allocated to the separate performance obligations in proportion to the standalone fair market value of the goods and services to be delivered as required by the revised ED, are there specific contractual terms that may result in a difference between the allocation for tax and book accounting?
- To the extent tax accounting methods differ from book accounting methods, are there any new tax data and systems requirements that need to be taken into consideration?
- Are there any cash tax implications in foreign controlled entities that, for example, maintain statutory accounting records under IFRS?
- Will the potential changes to the timing or measurement of U.S. GAAP or IFRS revenue impact the approach taken for calculating state and local transaction taxes?

Takeaways

In order to avoid unintended consequences and plan for potential opportunities, it is important that tax departments analyze the tax implications of the changes in the revenue recognition accounting standard. Companies should review their current tax accounting methods related to the standard in anticipation of any changes, particularly those companies that have historically followed financial reporting for tax purposes, to better understand the potential impact on future cash flow. It is also important that tax departments collaborate with other financial reporting groups, including treasury and accounting, to understand the implications that may arise in foreign jurisdictions. Finally, it will be important for tax departments to stay attuned to the changes in accounting, data, and systems modifications adopted to accommodate the new accounting standard that is likely to impact the data needed for tax reporting.

SEC receives comments on incorporating IFRS into the U.S. financial reporting system

In its May 26, 2011, staff paper, the U.S. Securities and Exchange Commission (SEC) staff elaborated on and requested comment on a possible method of incorporating International Financial Reporting Standards (IFRS) into the U.S. financial reporting system. The comment period on the staff paper ended on July 31, 2011, and more than 140 letters were received expressing respondents' views on a possible framework.

The feedback from the comment letters generally indicated broad support for a single set of high-quality globally accepted accounting standards, as well as agreement with key elements of the transition approach contemplated by the SEC staff in the staff paper.

The following describes the main takeaways from the comment letters:

- Overall, respondents largely supported having a single set of high-quality globally accepted accounting standards, and most viewed such standards as an important cornerstone of the global economy.
- Concerns were raised related to the evaluation of the International Accounting Standards Board's (IASB) standard-setting process and the quality of IFRS relative to U.S. Generally Accepted Accounting Principles.
- The transition schedule following a phased approach versus a single effective date for U.S. issuers raised significantly different comments depending on the characteristics of the companies who responded.

- Most preparers declared in favor of prospective versus retrospective application of IFRS to minimize the impact of transition.
- Most encouraged the SEC to allow an option to voluntarily adopt IFRS during the transition period.
- Significant support was expressed for the U.S. Financial Accounting Standards Board (FASB) to continue to be heavily involved in the standard-setting process and in protecting the interests of U.S. constituents.
- Most agreed that the SEC should continue to have a primary role in protecting investors and, as such, issue reporting and accounting guidance even though the preferred method for issuing guidance would be through the IASB's standard-setting process, with the FASB's endorsement.

In July 2011, the SEC held [roundtable discussions](#) on the benefits and challenges related to potentially incorporating IFRS into the U.S. financial reporting system. The views expressed by participants were broadly consistent with the main themes in the comment letters on the staff paper.

For additional information on the comments received, please view [Heads Up: SEC Receives Comments on Potential Method of Incorporating IFRSs Into U.S. Reporting System](#).

Additional news from the SEC

In February 2010, the SEC directed its staff to initiate a work plan to help it determine whether, when, and how to incorporate International Financial Reporting Standards (IFRS) into the U.S. financial reporting system. Under the work plan, the staff was required to assess the sufficient development and application of IFRS.

As a result of this assessment, the staff published two papers on November 16, 2011:

- **A Comparison of U.S. GAAP and IFRS** — The SEC staff reviewed 29 ASC topics and compared them with corresponding guidance in IFRS
- **An Analysis of IFRS in Practice** — The SEC analyzed a selection of annual IFRS consolidated financial statements of both SEC registrants and nonregistrants

Read our publication [Heads Up: SEC Compares IFRSs With U.S. GAAP and Analyzes IFRSs in Practice](#) for more detailed information about the two staff papers.

IFRS Summit addresses accounting convergence issues

Deloitte's fourth annual IFRS Summit was held on October 18 in New York City and was attended by more than 165 people who heard about the incorporation of International Financial Reporting Standards (IFRS) into the U.S. public company financial reporting framework. An additional 75 people watched as part of a live video simulcast to Lima, Peru. Featured speakers included International Accounting Standards Board (IASB) Chairman Hans Hoogervorst and U.S. Financial Accounting Standards Board (FASB) Chairman Leslie Seidman, who shared their perspectives on the incorporation of IFRS, convergence efforts, and progress on the Securities and Exchange Commission's IFRS Work Plan.

We'll soon have video clips available on our website, so check out www.deloitte.com/us/ifrs in the coming weeks for those links.

As used in this document, "Deloitte" means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.



Deloitte & Touche LLP partner Joel Osnoss (L) speaks with IASB Chairman Hans Hoogervorst (R).



FASB Chairman Leslie Seidman (L) and Deloitte & Touche LLP partner Bob Uhl (R) address the crowd.

Looking to earn some CPE credits?

If you want to learn more about accounting convergence and International Financial Reporting Standards (IFRS), consider taking one of our e-learning training courses which qualify for CPE. The program consists of 14 courses — one to three hours each in length — which provide a detailed review of many significant technical IFRS requirements. They focus on cross-industry issues and will provide you with the basic knowledge needed to understand the differences between U.S. Generally Accepted Accounting Principles and IFRS.

Available courses

1. IFRS 1, First-Time Adoption of IFRS
2. IFRS 7, Financial Instruments: Disclosures
3. IAS 2, Inventories
4. IAS 10, Events after the Reporting Period
5. IAS 11, Construction Contracts
6. IAS 18, Revenue
7. IAS 24, Related-Party Disclosures Statements
8. IAS 27, Consolidated and Separate Financial
9. IAS 32/39, Financial Instruments Accounting
10. IAS 34, Interim Financial Reporting
11. IAS 36, Impairment of Assets
12. IAS 37, Provisions, Contingent Liabilities, and Contingent Assets
13. IAS 38, Intangible Assets
14. IAS 39, Financial Instruments: Hedge Accounting

These courses are convenient, flexible, and interactive; they can be taken anytime and anywhere, subject to a nominal monthly per user subscription fee. Participants can earn 27 CPE credits for completing all 14 courses.

We offer subscription pricing of \$40 per user per month. Register for, pay for, and access these courses at www.deloitte.com/us/ifrslearningcenter.

IFRS contacts

Joel Osness

Partner
Deloitte & Touche LLP
+1 212 492 3910
josness@deloitte.com

Nick Difazio

Partner
Deloitte & Touche LLP
+1 313 396 3208
ndifazio@deloitte.com

Tom Omberg

Partner
Deloitte & Touche LLP
+1 212 436 4126
tomberg@deloitte.com

Renee Bomchill

Partner
Deloitte & Touche LLP
+1 212 436 6836
rbomchill@deloitte.com

This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte, its affiliates, and related entities shall not be responsible for any loss sustained by any person who relies on this publication.