



Background of the 3rd Advisory Forum

EFRAG recently held its third Advisory Forum on Revenue Recognition, the aim of which was to debate and obtain input from high-level representatives of key stakeholders (such as preparers, users, standard setters, regulators and auditors) on this topical issue.

The objective of the Advisory Forum was not to reach conclusions but to provide a basis for an exchange of views that would enable EFRAG to approach those responsible for standard setting and commenting with a European perspective.

The key questions that were covered in the Forum were:

- What is revenue?
- When does revenue arise?
- How do we recognise revenue?

The debate was supported by an extract from the draft discussion paper “Revenue Recognition: Towards a European View” which summarises the issues at stake. The discussion paper itself, is expected to be published shortly after the Advisory Forum, once approval from the participants in the Proactive Accounting Activities in Europe has been obtained.

Summary of the 3rd Advisory Forum

The meeting was opened by Hans Van Damme, member of the EFRAG Supervisory Board, who reminded the audience of the importance of being pro-active in connection with standard setting as well as the important role that EFRAG should and is playing in this connection. He reminded the audience that speaking with one voice in Europe was of great importance and that therefore, people should use the opportunity to share their thoughts. In his concluding comments he stressed again the importance of the working agreement between EFRAG and the European Commission and highlighted that in order for EFRAG to be able to fulfil its role to the fullest extent, sufficient funding of its operations would need to be secured.

Hans Van Damme was succeeded by Pierre Delsaux, acting Director of the Directorate F of the European Commission. Mr. Delsaux also stressed the importance of EFRAG and noted that the co-operation between EFRAG and the European Commission had been very successful so far; he added that he was certain that these good relations would continue in future. He pointed out that Europe took an important step with the implementation of IFRS in 2005 and stated that the Commission had tendered a survey on the implementation of IFRS in the European Union.

Ian Mackintosh, Chairman of the UK ASB and facilitator of the forum, introduced the topic of the day, i.e. revenue recognition. He set the scene by pointing out the importance of revenue. He quoted the draft discussion paper by stating: “Everyone knows what revenue is. Or so it is often claimed. Yet, on closer inspection it becomes clear that, except in the simplest of transactions, there

is little agreement as to what revenue is and when exactly it arises.” This might not have mattered—or at least might not have been a priority—had the application of the existing revenue recognition standards not been so problematic and rife with inconsistencies : real difficulties have arisen in recent years as business models have evolved and new transaction-types have emerged. Consequently, different entities and industries have adopted practices that are often inconsistent, therefore revenue recognition issues have recently become the source of more discussion than almost any other area of accounting. In such circumstances the answer usually lies in identifying clear principles that can be applied consistently. Unfortunately, it has to date proven difficult to identify such principles from current revenue recognition practice because of the inconsistencies that exist.

He introduced the following members of the panel to the audience:

1. Bernard Boisselier, Group Senior VP Finance, Atos Origin SA;
2. Philippe Danjou, Chief Accountant, AMF (France) and future IASB Board member;
3. Sven Hayn, Chair of the IFRS Area Desk for Central Europe, Ernst & Young AG;
4. Liesel Knorr, Secretary General, German Standard-setter GASC;
5. Geoffrey Whittington, Emeritus Professor of Financial Accounting at the Cambridge University and former member of the IASB;
6. Stig Enevoldsen, Chairman of EFRAG TEG.

Stig Enevoldsen introduced the topic by pointing out the problems faced with the current IFRS literature on revenue recognition, in that neither IAS 18 nor IAS 11 contain sufficiently detailed guidance; Additionally the 2 standards are considered to be partly contradictory. Especially the lack of guidance on multi-element arrangements is considered to be one of the major problems of the existing IFRS literature. In contrast to this, US GAAP has a vast number of rules, which are however considered to be in need of a major overhaul as well. Therefore, the IASB and FASB started with a convergence project on revenue recognition, which is now going on for quite a while with views changing from one side to the other.

The EFRAG TEG chairman then updated the participants of the forum on the Pro-active Accounting Activities in Europe (PAAinE) initiatives. One of the papers prepared by the Group was on revenue recognition, of which an extract was provided to the participants of the day. The draft paper, which is expected to be published before year-end, was developed, in collaboration with the German standard setter. Stig Enevoldsen then explained the four models which were considered in the draft discussion paper, and which are set out below:

1. Completed Contract Model;
2. Completed Part Contract Model;
3. Part Output has a Value to Customer Model; and
4. Continuous Approach.

Based on some examples, he then explained how the different models would be applied in the different cases.

He concluded his introduction by stressing to the audience and the panellists that, for the forthcoming discussion, participants should bear in mind the following questions:

1. Has there been a critical event and is that of importance for revenue recognition?
2. Is there a performance obligation and what is the impact on revenue recognition?
3. When applying the different models, does it satisfy the asset/liabilities approach?
4. Has there been contingent acceptance?
5. Is there a right to consideration?

The different panellists then gave a brief synopsis of where they believed the problems with current IFRS literature lay, and provided the audience with some practical examples to illustrate their point. These examples ranged from the possibility to return goods bought, to IT consulting contracts to multi-element mobile phone contracts. The fundamental question of whether revenue represents a measure of economic activity or a discharging of an obligation was raised.

During the discussion various contentious issues were raised, such as the relevance of prudence during the revenue recognition process; the extent to which the various types of risks (e.g. return rights and credit risks) should impact revenue recognition; the need and / or desire of industry specific guidance (general principles versus detailed rules); and finally, if a characteristic of revenue should be that it can never be reversed.

Some key questions raised during the forum discussions:

1. To what extent should credit risk drive the recognition of revenue?
2. Does revenue have to be irreversible before it is allowed to be recognised? Should we re-state revenues at all?
3. Execution risk versus credit risk? Which of the two risks should have a greater weighting in the determination of revenue to be recognised? Is credit risk more of a 'cost' related risk, as opposed to a 'revenue' related risk?
4. Do we build the uncertainty (risk) into the measurement aspect of revenue?
5. How about different revenue recognition approaches for different classes for risk?
6. Can we distinguish between 'hard' and 'soft' revenues?
7. Should the quality of earnings be reflected in the determination of revenue to be recognised?
8. Revenue streams and risk profiles can be industry specific. Doesn't this warrant the preparation of revenue accounting standards that are industry specific?
9. What are our expectations regarding principle based standards? Where do we draw the line in terms of how detailed guidance should be on matters such as revenue recognition?
10. Isn't there a greater need for the disaggregation of revenues, in order for users to be able to better understand the different revenue streams?

Quotes of the day:

1. Accounting is a 'convention', and should not become a 'science'.
2. A 'one size fits all' approach does not work for all revenue recognition issues.

Ian Mackintosh summarized the day by giving his view on whether the objectives of the forum had been met, and handed over to Hans Van Damme again, who concluded the meeting by thanking the participants for attending the forum. He concluded that the discussions today highlighted the importance of this issue and that people should ensure that similar discussions are happening in the different member states, in order to ensure that EFRAG can eventually play the pro-active role it was intended to play and act as Europe's voice to the IASB.

Note:

The presentations of the individual panellists will be available for download on the EFRAG homepage (www.efrag.org).