INTERNATIONAL ACCOUNTING TREATMENT REGARDING REVENUE

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Abstract
This paper discusses the news on international accounting treatments of revenue arising from the extensive process of convergence between IASB and FASB that began in 2002. The starting point of this approach is to identify the treatments currently applicable to income. Finally we presented a summary of the main provisions of the new standard IFRS 15 "Revenue from Contracts with Customers", which replaces IAS 11 and IAS 18 (as well as a number of SIC and IFRIC interpretations) required to be applied from January 1, 2017, emphasizing the potential impact on entities.

Keywords**:** income, revenue, IFRS, US GAAP, standards

JEL Classification: *M40, M41*

1. Introduction

Revenues include the amounts or values received or receivable on one's own behalf from current activities, as well as the gains from any other source [1]. Current activities are any activities conducted by an entity under its scope of activity, as well as its related activities.

The revenue from current activities can be found under different names such as: sales, service provisions, fees, royalties, rents, subsidies, interests, dividends.

The amount of revenue arising from a transaction is usually determined by agreement by and between the seller and the buyer / user of the asset, taking into account the amount of any trade discounts.

Internationally, the accounting treatments, in general, as well as those related to revenue, in particular, are prescribed by IASB and FASB.

2. Existing international accounting treatments of revenue

Depending on the type of income, IASB proposes accounting treatments found mainly in the content of the following standards [2] (plus a number of interpretations such as SIC-31 and IFRIC-13, 15 and 18):

- IAS 11 – for revenue resulting from construction contracts;
- IAS 17 – for revenue resulting from lease contracts;
- IAS 18 – for current revenue such as sales of goods, provision of services and the use by others of enterprise assets as interest, royalties and dividends;
- IAS 20 – for revenue such as government grants;
- IAS 21 – for revenue resulting from changes in foreign exchange rates;
- IAS 28 – for dividends arising from investments accounted for under the equity method;
- IAS 36 – for revenue resulting from the resumption of impairment losses;
- IAS 37 – for revenue resulting from the resumption of provisions;
- IFRS 4 – for revenue arising from insurance contracts;
- IFRS 9 – for revenue arising from changes in the fair value of financial assets and financial liabilities or the disposal thereof;
- IAS 41 – for revenue arising from the initial recognition of agricultural production, as well from the recognition of changes in fair value of the biological assets related to the agricultural activity.

In contrast, FASB – the American standardization body, has over 100 standards in force on revenue recognition, most of them with an industrial nature (developed by bodies such as EITF, AICPA, SEC, etc.).

The main differences and similarities between the IFRS provisions on revenue and US GAAP, i.e. Order No. 3055/2009 have been discussed in another paper [3].

The convergence process between the two world bodies (IASB and FASB) could not ignore the income category, especially given the large number of standards that aimed and still aim the accounting treatment of revenue (especially the recognition thereof) and the differences and similarities between them.

3. Convergence between IFRS and US GAAP

The convergence process [4] between the two largest global standardizers, IASB and FASB, started in 2002, and major efforts were made to achieve convergence between IFRS and the generally accepted accounting principles (US GAAP). The development of a common set of high quality standards has been the priority of the said convergence process. Thus, in September 2002, IASB and FASB agreed to work together, in consultation with other national and regional bodies, in order to eliminate the differences between the international standards and US GAAP. This decision took the form of a Memorandum of Understanding between the two bodies, known as the Norwalk Agreement. The commitment was further strengthened in 2006, when IASB and FASB established the specific steps to be achieved by 2008 (as a timetable of the convergence process 2006-2008).

Given the progress made by the two bodies and by other factors, in 2007 the SEC (American body whose mission is to protect investors and facilitate capital formation - "Securities and Exchange Commission") eliminated, for the non-US companies registered in the United States, the requirement to prepare the financial statements in compliance with US GAAP provisions, if they comply with the requirements of IFRS issued by IASB. Meanwhile, the SEC published a timetable for adopting IFRSs for the domestic companies in the USA.

In 2008, the two bodies updated the initial Memorandum of Understanding, identifying a number of priorities and milestones and highlighting the objective of developing common standards, based on principles.

The G20 Group also called for intensified efforts to complete the convergence of the accounting standards worldwide. Following such request, in November 2009 the IASB and FASB published a progress report describing their intensified work program, including the hosting of joint monthly meetings of the Governing Boards, as well as the quarterly updating of the convergence steps.

In April 2012, the IASB and FASB published a joint progress report on the financial instruments, including the impairment of assets and provisions, as well as a convergent approach on the classification and measurement (IFRS 10, 11 12 and 13 were published in May 2011).

In February 2013, the IASB and FASB published an updated convergence timetable, especially with respect to the impairment losses on financial instruments. The final version of IFRS 9 was published on July 24, 2014 (with mandatory application from January 1, 2018).

With respect to income, the convergence process is revealed by the publication of IFRS 15 on May 28, 2014.

4. Accounting treatment prescribed by IFRS 15 – Revenue from contracts with customers

As shown above, the revenues have been a priority in the process of convergence, existing as a project on the convergence agenda ever since 2002. Following this process, the "Preliminary Views on Revenue Recognition in Contracts with Customers" ("Păreri preliminare cu privire la veniturile din contractele cu clienții") was published on December 19, 2008, followed by the exposure drafts of June 24, 2010 and November 14, 2011. The end result is the new standard IFRS 15 –" Revenue from Contracts with Customers" (published on May 28, 2014) replacing IAS 11, IAS 18, IAS 31 and IFRIC 13,15 and 18 and with mandatory application from January 1, 2017 [4, 5, 6].

IFRS 15 has not yet been approved in the European Union; based on the EFRAG estimates, it will take place in the second quarter of 2015 [7], new guidance for the application may be issued until the effective date of the standard.

The aim of issuing this standard consisted of formulating a joint revenue recognition model applicable to the contracts with customers, regardless of the industry of the entities that would ensure the comparability principle.

We shall outline below a summary of the main provisions of the new standard, focusing on the potential impact on entities.

IFRS 15 applies to contracts with customers, except those covered by other standards, such as: IAS 17 - Lease contracts, IFRS 4 - Insurance contracts and IAS 39 or IFRS 9 - Financial Instruments.

The customer is defined as a party that has concluded a contract with the entity in order to obtain goods and services resulting from the ordinary activities of the entity. However, the transfer of assets not related to the ordinary activities of an entity (such as sales of tangible and intangible assets or property investment) must comply with certain requirements for recognition.

The recognition of interest and dividend income no longer falls within the scope of IFRS 15.

The basic principle of IFRS 15 is that revenue recognition should describe the transfer of goods and services to customers and their evaluation must reflect the consideration to which the entity expects to be entitled in exchange for such goods and services.

Revenue recognition is the result of going through the following five stages:

a. Identification of the contract with a customer

The requirements of IFRS 15 apply to the contracts with customers that meet certain conditions. A contract is defined as an agreement between two or more parties that creates enforceable rights and obligations. An entity accounts for a contract with a customer only if the following conditions are met:

- the parties have approved the contract and agree to meet their obligations,
- the entity can identify each party's rights on the goods and services transferred,
- the entity can identify the payment terms for the goods and services transferred,
- the contract has commercial substance (that is, it changes risk, timing and amount of the entity's future cash flows)
- the entity is likely to collect the consideration to which it is entitled in exchange for the goods and services transferred to the customer. This involves assessing the customer's ability and intention to pay the consideration when it is due.

The consideration received by entity from a customer may be recognized as income only if one of the following events occurs:

- the entity has no outstanding obligations to transfer goods or services to the customer and the entire or most of the consideration promised by the customer has been received and is not refundable
- the contract was executed and the consideration received from the customer is not refundable.

Any consideration received from a customer is recognized as a liability until the above conditions are met (whether it is a liability to deliver goods or services, or a liability to refund the consideration).

If at the beginning of the contract it meets the conditions for being accounted for as a contract under IFRS 15, the entity shall reassess its classification only if there is evidence of a significant change in the original facts and circumstances. For example, if the customer's ability to pay deteriorates significantly, the entity shall reassess whether it is likely to collect the consideration that it will be entitled to in exchange for the goods and services to be transferred to the customer.

The amendment of contract is treated as a separate contract (unless giving rise to additional obligations and its price reflects its price at the time of amendment) or as an adjustment to the original contract, accounted for by the method of adjustment of accrued income or income prospective adjustment method, based on the circumstances. For example, for a construction contract, a sale price of RON 600,000.00 is estimated and total costs of RON 520,000.00. In the middle of the contract (when the work progress degree was 50%) the beneficiary requires changes that increase the total cost by RON 50,000.00 and the total price by RON 70,000.00. In this case, the change is treated as part of the original contract, because it does not give rise to additional obligations. The total costs are reviewed at RON 570,000.00 and the total estimated price is reviewed at RON 670,000.00. The total revenue recognized to date is reviewed under the new conditions.

b. Identification of the obligations arising from the contract

A contract includes obligations to transfer goods or services to a customer. An obligation to transfer a good or service is separable if it cumulatively meets the following conditions:

a) the customer may enjoy the transferred good or service separately or in combination with other available resources

and

b) the entity's promise to transfer the good or service to the customer is identified separately from other promises under the contract.

For example, if an entity grants warranties to the customer, the warranty nature determines its accounting treatment. If the customer can choose whether or not to purchase the warranty or if the warranty provides it with an additional service, it is a separate obligation. If the warranty simply means that the good delivered meets certain specified conditions, then it is not a separate obligation.

c. Determination of the transaction price

The entity shall determine the amount of consideration that is expected to be entitled in exchange for the goods and services promised in the contract to recognize revenue. The transaction price includes an estimate of any variable consideration, the effect of the time value of money (if there is a significant financial component), the effect of any consideration payable to the customer. For sales or royalties arising from the use of licenses, the entity shall not include such consideration in the price before the sale or use takes place.

The price may be a fixed amount or may vary due to rebates, incentives, bonuses or other similar items. The transaction price is adjusted for the effect of the time value of the money if the contract contains a significant component of funding. If the price includes a variable component, the amount of the consideration is estimated using either the expected value technique or that of the most probable value. The estimated amount of the variable consideration will be included in the transaction price only if it is likely that there will not be a significant cancellation of the accrued income when the uncertainty associated with the variable consideration is eliminated.

Determining the existence of a significant component of funding can be complex for the long-term contracts with multiple elements, when the goods and services are delivered and the payments are made during the contract. Management will need to assess the time of delivery of goods and services and that of payment and if the difference between the two moments exceeds one year, it could be an indication that there is a significant component of funding. The amount of recognized income will be different from the amounts received in the event of advance or subsequent payments.

If the consideration provided by the customer is non-monetary, it is measured at fair value. If the entity can not determine its fair value, it will be estimated indirectly based on the selling price of the goods and services transferred to the customer. If a customer contributes with goods and services to facilitate the contract execution by the entity, it will appreciate if it gets control of such goods and services. In this case, the goods and services received are treated as non-monetary consideration from the customer. A consideration that is paid by the entity to the customer (e.g., in the form of coupons, vouchers) is accounted for as a reduction in the transaction price and hence in the income, unless it is given in exchange for other goods or services.

d. Allocation of the transaction price between the obligations arising from the contract

If a contract contains several separate obligations, the entity allocates the transaction price of each obligation commensurate with its individual price. The best evidence for the price of each obligations is the price at which the good or service is sold separately by the entity. If not available, the entity will need to estimate it using an approach that maximizes the use of observable inputs.

e. Revenue recognition as the entity meets the requirement

A general contract obligation is met when the control of goods or services is transferred to the customer. Control is the ability to decide the use and to get most of the remaining benefits related to the transferred goods or services. This approach differs from that previously put forward by IAS 18, under which revenue is recognized when most of the risks and benefits arising from the ownership of goods are transferred to the customer.

According to IAS 18, different criteria are set for recognizing revenue from the sale of goods and revenue from the provision of services. The new standard proposes a different approach in order to determine whether revenue should be recognized at a particular time or over a period of time that applies to both the sale of goods and provision of services.

An obligation may be met at some point (as is usual for the transfer of goods) or over a period of time (as in the case of service provision).

An obligation is met and revenue is recognized over a period of time if at least one of the following conditions is met:

- the customer receives and consumes the benefits of the provision made by the entity as the entity provides the services,
- the entity's performance creates or increases the value of an asset that is controlled by the customer as the asset is created or its value is increased,
- the entity's performance does not create an asset that has an alternative use for the entity and the entity is entitled to payment for the performance made so far.

In order to determine whether the asset has an alternative use, the seller will have to consider at the beginning of the contract if, contractually or practically, it can use the asset for a purpose other than that provided for in the contract with the customer.

If an obligation is not met over a period of time, the evaluation of the time in which the asset control is transferred to the customer is established after analyzing the following factors:

- - the entity has transferred the physical possession of the asset,
- - the entity has the current right to demand payment for the asset,
- - the customer has accepted the asset,
- - the customer is exposed to significant risks and benefits incidental to ownership of the asset or
- - the customer is the owner of the asset.

5. Conclusions

The international revenue treatments are currently issued by IASB and FASB (discussed in section 1). After the convergence process, since January 1, 2017 a new standard must be applied, IFRS 15, which replaces some of the standards currently applied (IAS 11 and IAS 18, for example).

IFRS 15 includes criteria for determining whether a license ensures the right of access to intellectual property and involves the transfer of control over time or ensures the right to use the intellectual property for which the control is transferred at some point [7].

IFRS 15 also establishes the method of accounting of the incremental costs of obtaining a contract and the costs directly related to the contract performance. If the recovery of these costs is expected, they can be capitalized and subsequently amortized and tested for impairment. Most of the costs of obtaining the contract should be included in expenses (except those that would not have been incurred unless the contract had been obtained). Therefore, the incremental cost of obtaining the contract should be evidenced separately.

The standard is accompanied by illustrative examples regarding the choice of the method for measuring progress in meeting an obligation, accounting for return sales, issues related to situations where the entity acts as an agent or main party, the treatment of licenses, warranties, options for additional goods or services, compliance with the disclosure requirements etc.

IFRS 15 requires a greater use of the professional judgment and a broader use of the estimates. The standard contains extensive disclosure requirements on disaggregating total income in order to describe how the nature, amount, time of recognition and uncertainty of revenue and cash flows are affected by the economic factors, changes in balances (initial and final balances of receivables, assets and liabilities, revenue recognized in the current period that was previously included in the contract liability and the income recognized in the current period related to obligations met over a prior period) for contracts with a term of over one year, the amount of the transaction price allocated to the outstanding liabilities explanations related to recognition time of such income, information about the assets recognized for the costs of obtaining and executing contracts, qualitative descriptions of the goods and services, payment deadlines and the times of meeting the general obligation arising from the contracts with customers, key judgments and estimates used in revenue recognition, policies used by the entity on the time value of money and the costs of obtaining or executing a contract, methods, inputs and assumptions used to determine the transaction price and to allocate it between the liabilities arising from the contract.

The standard is effective for the accounting periods beginning on or after January 1, 2017 and applies to the contracts signed after that date or that are not yet settled at this time. For the comparative amounts, the entities have the option of using either retrospective application or a modified approach which consists in recognizing the cumulative effect of applying the standard as an adjustment to the opening balance of the earnings reported on the date of entry into force (January 1, 2017), while the comparative amounts for December 2016 are not retreated.

IFRS 15 will produce changes especially in the accounting of long-term contracts with multiple elements. For example, a seller of cars providing service with the sale will have to assess whether the goods and services transferred are distinct and recognize revenue when they are transferred to the customer.

In the telecommunications industry, contracts can often provide for the sale of a mobile phone and telephony services over a certain period (one or two years). According to IFRS 15 the transaction price that includes the amount paid to conclude the contract and the monthly payments for telephony services is allocated between the sale of the mobile phone and the telephony services based on the relative weight of the individual price of each item. These entities will have to collect information about the individual prices of different items.

In some cases there is no observable selling price (e.g., there is no observable prices for upgrades and additional features for the computer programs). If there are no observable prices, in compliance with IFRS 15, allocation is based on estimated prices.

For the entities selling software products, the nature of these programs and contractual terms will have to be analyzed carefully. The entities selling real estate ensembles have difficulty in treating the asset building as a provision of services (for which revenue is recognized over a period) or sale of goods (for which revenue recognition is performed at some point).

IFRS 15 details the criteria that must be met to recognize revenue over a period of time and when the revenue should be recognized at some point, without distinction between goods and services. Construction contracts and some contracts for the production of assets must be reassessed in the light of the new rules. The provisions related to amendment of contracts should be examined by entities in the construction industry.

IFRS 15 includes guidance for assessing the income when the consideration includes variable elements that determine the component of funding (which may particularly affect long-term contracts where payments from customers and meeting their obligations occur at different times). The recognition of revenue from royalties may be affected by the new standard.

Applying for first time IFRS 15 may mean for some entities postponement or earlier recognition of revenue, reconsidering current terms of contracts and business practices, updating computer programs to collect new information required by the standard, new estimates and judgments, review of processes and internal controls, gathering the information to be disclosed and communication with investors and other stakeholders in order to explain the standard's impact on the main indicators. The effects on the entities that must meet the needs of using more judgments and reasoning are not neglected. Given the fact that in Romania a number of entities are using the International Financial Reporting Standards as the basis of accounting, the fiscal impact should be carefully considered by the legislator and affected entities.

6. References

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