

Revenue recognition requirements in u.s. gaap, ifrs and iasb



Introduction

In an industry there are some accounting and financial standards that company must follow to be legal to incorporate. Therefore, accountants should follow some rules and guidelines, the International Financial Reporting Standards (IFRS) and U. S. GAAP, which adopted by the International Accounting Standard Board (IASB) and Financial Accounting Standard Board (FASB). The IASB is an independent, privately-funded accounting standard-setter based in London. It was founded on 2001 as the successor to the International Accounting Standards Committee (IASC). The Financial Accounting Standards Board (FASB) is a private, not-profit organization and it was created in 1973.

One of the general accepted accounting principles is the revenue recognition, which is an important principle in accrual accounting. It determines the specific conditions under which income becomes realized as revenue. Under IAS 18 “ Revenue, is defined as “ the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity other than increases relating to contributions from equity participants.” Generally, revenues are recognized when the amount of revenue is measured reliably, when it is probable that the economic benefits of the transaction will flow to the entity and when the costs (both incurred to date and expected future costs) are identified. (Jamil Khatri, Akeel Master 2009). Many problems involved in revenue recognition about the usefulness of the existing standards. So, in June 2002 the IASB and the FASB started a project to develop coherent conceptual guidance for revenue recognition and to <https://assignbuster.com/revenue-recognition-requirements-in-us-gaap-ifs-and-iasb/>

eliminate inconsistencies on the subject in their conceptual frameworks. Following we are going to analyze the main problems that occurred, the views taken by the two boards and a reasoned critique of their thinking.

Main body

Revenue recognition requirements in U. S. GAAP differ from those in IFRS. Accordingly IASB and FASB the main objectives of the project are to provide a single revenue recognition model that could apply consistently across various industries and transactions, to develop a model on changes in specific assets and liabilities that would eliminate inconsistencies in existing concepts and standards and to converge IFRS and U. S. GAAP requirements. (Barry J. Epstein Eva K. Jermakowicz , 2010)

However, some problems occurred from revenue recognition standards, which reduce the comparability of revenue across entities. In U. S. GAAP there are numerous standards that define an earnings process inconsistently. The application of the earnings process provide more than 100 standards on revenue and gain recognition which some of them are industries specific and can produce conflicting results for economically similar transactions. This has a result, people disagree how it applies to particular situations. Despite the numerous standards, there are also gaps in guidance which creates conflixtions with asset and liability definitions. Sometimes earnings process leads to a misrepresentation of an entity's contractual rights and obligations in financial statements. Thus, if they focus on changes in assets and liabilities the earnings process could be improved. (Putra 2010)

IFRS contain fewer requirements than U. S. GAAP, but also those standards need improvement. The revenue recognition standards provide inconsistencies between assets - liability approach. Under the asset - liability approach, revenue recognized by direct reference to changes in assets and liabilities that occur from an entity's contract with a customer, rather than by direct reference to critical events. (Barry J. Epstein Eva K. Jermakowicz , 2010) Another deficiency in IFRS relates to the lack of guidance for transactions involving multiple-element arrangement. IAS 18 does not state clearly when or how an entity should separate a single transaction into components and how to measure the elements in a multiple-element arrangement. Therefore, entities apply different measurements for similar transactions, which reduce the comparability of revenue across entities. Also, some problems occur and from the distinguishing between goods and services. If there was a clear principle to ever-changing and increasingly complex transactions then gaps in guidance would not be a problem.(Putra 2010)

However, the Boards have reached some preliminary views in developing a revenue recognition model. Following I will summarize those views. Firstly, the proposed model would apply to contracts with customers. Revenue should be recognized on the basis of increases in an entity's net position in a contract with a customer. When an entity enters into a contract with customer, the company gets rights to payment from the customer and assumes obligations to provide good and services to the customer.

When an entity satisfies a performance obligation in the contract then company should recognize revenue. Performance obligation is a promise in a <https://assignbuster.com/revenue-recognition-requirements-in-us-gaap-ifs-and-iasb/>

contract with a customer to transfer a good or service to that customer. If an entity promise to provide a good, then it is a promising to transfer an asset to the customer. Moreover, if the promised goods or services are transferred to the customer at different times then entity accounts of performance obligations will separate. The aim to separate performance obligations is to ensure that the revenue of the entity is representing the pattern of the transfer of assets to the customer, over the life over the contract. An entity satisfies a performance obligation when the promised good has transferred to customer. We know that an entity has transferred that promised asset when the customer obtains control of it. Consequently, activities that an entity undertakes in fulfilling a contract result in revenue recognition only if they simultaneously transfer assets to the customer.

The boards have not yet expressed a preliminary view on how an entity would measure the rights. However, the rights will measure based on the amount of the transaction price (the promised consideration). As the boards propose, performance obligations should be measured at the transaction price. If a contract comprises more than one performance obligation, an entity would allocate the transaction price to the performance obligations in proportion to the stand-alone selling prices of the goods and services underlying those performance obligations. As each obligation is satisfied, the amount of revenue recognized is the amount of the transaction price that was allocated to the satisfied performance obligation at contract inception.

Finally, the boards propose that after contract inception, a company should remeasure a performance obligation when it is deemed 'onerous'. A

performance obligation is estimated 'onerous' when an entity's expected
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cost of satisfying the performance obligation exceeds the amount of that performance obligation. In that case, the performance obligation is remeasured to the entity's expected cost of satisfying the performance obligation and the entity would recognize a contract loss.

As we can see, the proposal model on how and when revenue is recognized under both IFRS and US GAAP are likely to discuss from the entities. The objective of the project to develop a single revenue recognition model that would apply to a wide range of industries to improve the financial reporting revenue was very helpful for all the industries. It helps remove inconsistencies and weakness in existing revenue recognition standards and provide a stronger framework for revenue recognition issues. On the other hand, for many entities the implementation of the proposed model will be relatively ineffectual and for others, the process could be effectual. Specific, construction industries have concerns regarding how the indicators of control should be applied to long-term contracts. Also telecommunications and technology sector, express concerns about the requirement to determine a stand-alone selling price for each performance obligation. Therefore, both Boards should focus on fixing the problems in the existing standards, and to make a better model which will work well in practice.

It's obviously that many problems arise in determining when revenue is earned. Let's consider Apple, one of the biggest tech. industries in our days as a live example. Apple has the issue that " how FASB might rework the rules related to recognizing revenue for software that's bundled into a product and never sold separately". This is very important for Apple because it affects the revenue related to two of the company's most successful

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products, the iPod and the iPhone. If the rules are recast the company could be able to book revenue faster, yielding less time between product launches and associated revenue gains. Also it would drive up Apple's earnings and possibly stock price. (Marie Leone, 2009)

Conclusion

Having a clear enough view of the problems involved in revenue recognition and the views taken by the two boards, I've tried to paint a picture of the proposed revenue recognition model by the two Boards. The proposed model would not be easy and it would be difficult to apply in all entities. However, Boards are trying to develop a model without any inconsistencies and based on changes in specific assets and liabilities. It will take many hours of meetings and discussions between the two Boards before complete any issues about the proposed project.

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