

## Revenue recognition (Lecture A860 – 10.48 minutes)

The next 'headline' change is in respect of revenue recognition. This affects both FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*.

### Current requirements

Revenue is dealt with in FRS 102, Section 23 *Revenue* and in FRS 105, Section 18 *Revenue*. Both standards deal with revenue from:



While the current requirements are straightforward to apply, there has been criticism of the revenue recognition sections of UK and Ireland GAAP for being 'clumsy' and quite difficult to apply in certain situations. In recognition of this, the FRC took the decision to delete the entire sections of FRS 102, Section 23 and FRS 105, Section 18 and redraft the revenue recognition requirements.

### New revenue recognition requirements

There is a single comprehensive five-step model for revenue recognition for all contracts with customers, based on identifying the distinct goods or services promised to the customer and the amount of consideration to which the entity will be entitled to in exchange (see **3.3** below).

The FRC believes this will make it easier for entities to account for revenue transactions correctly and consistently across all sizes of entity and all contract types. In addition, the FRC believes:

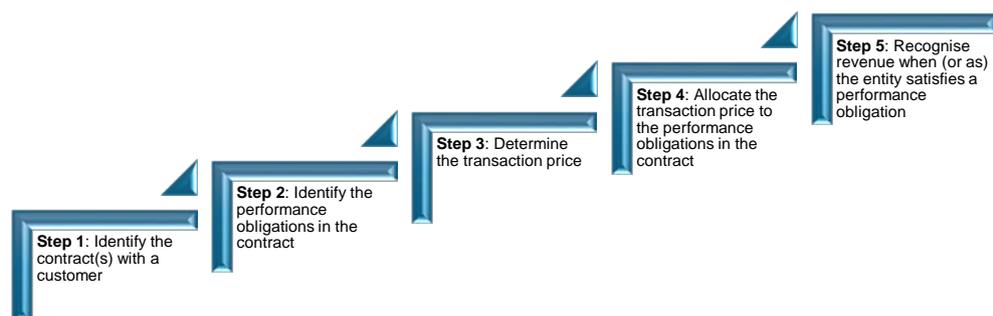
- There will be more reliable and useful information in the financial statements concerning the nature, amount and timing of revenue and cash flows arising from contracts with customers.
- High quality financial information supports a range of broader effects, potentially including improved access to capital.
- Consistency with international accounting principles is re-established, improving comparability and reducing 'GAAP differences'.

The first thing to note about FRS 102, Section 23 and FRS 105, Section 18 is that the title of the sections has been changed from *Revenue* to *Revenue from Contracts with Customers*.

For those preparers familiar with IFRS 15 *Revenue from Contracts with Customers*, it will be obvious which direction UK and Ireland GAAP is going in where this change is concerned and how revenue will be determined when the new requirements become mandatory.

### Five-step model approach

As noted in 3.2 above, there is a comprehensive five-step model approach to recognising revenue as follows:



The term ‘performance obligations’ features a lot in the above process and is defined as:

*A promise in a **contract** with a **customer** to transfer to the customer either:*

- (a) a distinct good or service (or a distinct bundle of goods or services); or*
- (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.*

It should be noted that (b) is not included in the definition contained in FRS 105.

Revenue will still be recognised at a point in time or over time, but the new requirements are more prescriptive on how different elements of a customer contract are disaggregated or combined and taken into account.

Steps 1 to 4 in the five-step model may, on the face of it, be straightforward to apply and the reality is that in practice these steps are generally applied across the board. Step 5, however, uses a single approach rather than the current approach of determining when the significant risks and rewards of ownership of the goods are transferred and the stage of completion for service contracts.

*Amendments to  
FRS 102 and  
other FRSs  
(March 2024)  
Glossary:  
**performance  
obligation***

However, the tricky part will be identifying an appropriate policy in the absence of current guidance to some of the difficult aspects of applying this five-step model, such as the prescriptive requirements for:

- identifying performance obligations in a contract;
- licensing and royalty revenue;
- non-refundable upfront fees;
- variable consideration, including customer refunds; and
- warranties, rights of return and customer acceptable clauses, and options.

We will consider some of the technical accounting issues relating to these in future quarterly updates.

### **Practical considerations**

Clients will need to carefully assess their revenue recognition accounting policies to ensure they are compliant with the new requirements in FRS 102 and FRS 105. There could be potential amendments to the timing of revenue recognition under the revised accounting treatments.

Entities will need to review their customer contracts in detail to apply the guidance and this may not be as simple as it first appears at first glance.

There are enhanced disclosure requirements which relate to classes of revenue; how and when revenue has been recognised; and unsatisfied performance obligations. In addition, if the entity has applied significant judgements in recognising revenue, these will also require disclosure. Accounting policies should also describe the point at which revenue is recognised (e.g. on dispatch of goods or when a customer receives those goods).

In terms of first-time application of the new requirements, FRS 102 allows an entity to choose either to amend its comparatives and apply the new five-step model to all customer contracts; or to apply the model to incomplete contracts at the start of the current period and adjust equity for the cumulative effect at that date. FRS 105 only allows the micro-entity to apply the revised Section 18 prospectively to contracts that begin after the date it first applies the periodic review amendments. Therefore, the micro-entity does not change its accounting policy for any contracts in progress at that date.