

## **Supplement to IASB Agenda Paper 7B/FASB Memo 162B - Collectibility**

In response to requests from some board members during the initial discussion of Agenda Paper 7B/162B, the staff have prepared some illustrative examples of possible approaches for presenting revenue and for presenting impairment losses arising from contracts with customers both with and without a significant financing component.

The staff think that these examples help to illustrate the presentation issues that were raised in Monday's joint board meeting. As such, in this supplement, the staff has re-ordered and revised questions 2-4 of Agenda Paper 7B/162B to more clearly identify the individual decision points associated with the presentation of revenue and corresponding impairments of receivables arising from contracts with customers.

The revised questions for the boards are as follows, **staff recommendations are outlined:**

**Topic 1 (Question 4 in paper)** – For presentation of impairments recognized on receivables, do the Boards prefer that:

- A. All impairments on receivables from contracts with customers are presented consistently (column [C]), as a result:
- Impairment on all contracts with customers, both with and without a significant financing component will be presented consistently.
  - Impairment on contracts with customers with a significant financing component will be presented differently from other impairments of loans receivables.

- B. All impairments on loans receivables (including those arising from contracts with customers with a significant financing component) are presented consistently (column [B]).

**Topic 2 (part of Question 3 in the paper)** – What is revenue from contracts with customers?

- A. For the hybrid company [NOTE: Total revenues for hybrid company would also include 13 of interest income.]?  
[A] = 1,502, [B] = 1,002 or [C] = 802
- B. For the manufacturer? [A] = 1,502, [B] = 1,002 or [C] = 802

**Topic 3 – (Question 2 in paper)** – Do the Boards prefer that all impairments (initial periods and subsequent periods) be presented consistently?

- A. All impairments, arising from initial periods and subsequent periods, should be presented together.
- B. Initial impairments should be a component of revenue and subsequent impairments should be an expense.

**Topic 4 – (part of Question 3 in the paper)** – Subject to normal materiality considerations, should impairment losses arising from contracts with customers be required to be presented on the face of the income statement?

- A. All impairments must be presented on the face of the income statement.
- B. Entities may present or disclose the impairment loss line.

**Assumptions for attached examples (based on the example in paragraph BC174 of the 2011 ED)**

- a) Each company has a calendar year-end.
- b) On November 1, each company sells two machines with delivery the same day (total of 1,502):
  - a. To Customer A with a transaction price of 751 on normal trade terms of 120 days.
  - b. To Customer B with a transaction price of 1,000 due in three years.
- c) The present value of Customer B's future payment is 751 using a discount rate of 10%.
- d) Collection is reasonably assured (US GAAP) / probable (IFRS) for both customers as of the date of sale.
- e) The cost of each machine is 400 (total of 800).
- f) During the quarter, each company determines that the receivable from Customer A is impaired by 500 and the receivable from Customer B is impaired by 200.
- g) Interest income of 13 is recognized for the quarter based on annual interest of  $75 \times 2/12$  of the year.
- h) Tax rate is 33%.

## Hybrid Company (manufacturer with captive finance)

Quarter ended December 31

	A	B	C
	Current GAAP <sup>1</sup> (all impairment losses recognized as expense)	2011 ED / Staff recommendation (Paper B)	All impairment losses adjacent to revenue
<b>Revenues</b>			
Contracts with customers:			
Sales of products	1,502	1,502	1,502
Sales of services			
Less: Customer credit risk		(500)	(700)
<b>Revenue from contracts with customers</b>		<u>1,002</u>	<u>802</u>
Revenues from finance operations	13	13	13
<b>Total revenues</b>	<u>1,515</u>	<u>1,015</u>	<u>815</u>
<b>Costs and expenses</b>			
Cost of products	800	800	800
Cost of services			
Selling, general and administrative	500		
Interest expense from finance operations			
Provision for losses on financing receivables	200	200	
Other costs and expenses			
<b>Total costs and expenses</b>	<u>1,500</u>	<u>1,000</u>	<u>800</u>
<b>Earnings from operations</b>	<b>15</b>	<b>15</b>	<b>15</b>
Other and non-operating income			
<b>Earnings before income taxes</b>	<u>15</u>	<u>15</u>	<u>15</u>
Income tax expense (benefit)	5	5	5
<b>Net earnings</b>	<u>10</u>	<u>10</u>	<u>10</u>

## Manufacturer

Quarter ended December 31

	A	B	C
	Current GAAP <sup>1</sup> (all impairment losses recognized as expense)	2011 ED / Staff recommendation (Paper B)	All impairment losses adjacent to revenue
Contracts with customers:			
Net sales	1,502	1,502	1,502
Less: Customer credit risk		(500)	(700)
<b>Net revenue from contracts with customers</b>		<u>1,002</u>	<u>802</u>
Cost of sales	800	800	800
<b>Gross margin</b>	<u>702</u>	<u>202</u>	<u>2</u>
Operating expenses:			
Research and development			
Selling, general and administrative	700	200	
<b>Total operating expenses</b>	<u>700</u>	<u>200</u>	<u>-</u>
<b>Operating income</b>	<b>2</b>	<b>2</b>	<b>2</b>
Interest income, net	13	13	13
Other income and expense			
<b>Income before income taxes</b>	<u>15</u>	<u>15</u>	<u>15</u>
Income tax expense (benefit)	5	5	5
<b>Net income</b>	<u>10</u>	<u>10</u>	<u>10</u>

1 = This view is consistent with Current GAAP if either (a) there were no recognition threshold or (b) the recognition threshold is assumed met as of date of sale.