MEMORANDUM

DATE: 28 July 2010

TO: MEMBERS OF THE FINANCIAL REPORTING STANDARDS BOARD AND AUSTRALIAN ACCOUNTING STANDARDS BOARD

FROM: CLIVE BRODIE
SENIOR PROJECT MANAGER – ACCOUNTING STANDARDS

SUBJECT: SUMMARY OF IASB EXPOSURE DRAFT *REVENUE RECOGNITION IN CONTRACTS WITH CUSTOMERS*

Purpose

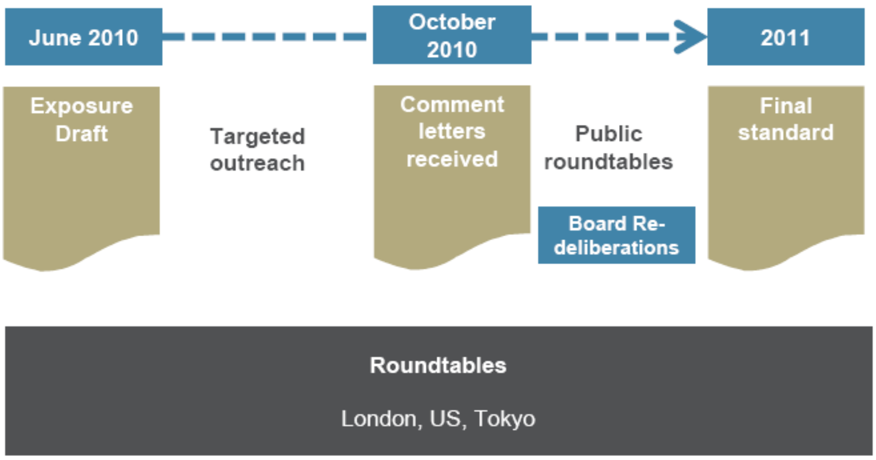
1. The AASB and FRSB (the Boards) are asked to consider key issues to be raised in their comment letters on the International Accounting Standards Board (IASB) Exposure Draft ED/2010/6 *Recognition of Revenue in Contracts with Customers* (included as agenda item 6.5) based on their previous comments on the preceding Discussion Document *Preliminary Views on Revenue Recognition in Contracts with Customers.*

2. This memo includes:
   a) The IASB's revenue project timeline;
   b) a summary of the project objective, revenue definition and scope;
   c) a summary of the IASB's Exposure Draft and comments on the Exposure Draft. The comments are based on the AASB and FRSB comment letters on the IASB's Discussion Paper *Preliminary Views on Revenue Recognition in Contracts with Customers*.

3. For noting, provided in memo 6.2 is FRSB staff's assessment of the potential impact of the IASB's proposals.

Project timeline[1]

4. The IASB's revenue project timeline is illustrated below. Comments on the Exposure Draft are due by 22 October 2010.



[1] Revenue recognition presentation from the IASB's London IFRS Conference 23 June 2010

Project objective, definition of revenue and scope

Project objective

5. The objective of the revenue project is to develop a single, principles-based revenue recognition standard for use across various industries and capital markets. In particular, the objective is to clarify the principles for recognising revenue and to develop a common revenue standard for International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (US GAAP) that would:
   a) remove inconsistencies and weaknesses in existing standards and practices;
   b) provide a more robust framework for addressing revenue recognition issues;
   c) improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets; and
   d) reduce the number of requirements to which entities must refer.

> *Note for the Boards:*
>
> *The Boards supported the objective of the project and convergence with US GAAP. However, the Boards were concerned that the objective of a single and comprehensive standard for revenue applicable to a range of industries would not be achieved. This is because of the potentially narrow scope of the project and focus only on revenue arising from contracts with customers.*

Definition of revenue

6. Revenue is defined as income arising in the course of an entity's ordinary activities. ('Ordinary activities' is not defined.) Income is defined as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decrease of liabilities that result in increases in equity, other than those relating to contributions from equity participants. These two definitions combined effectively retain the current definition of revenue within IAS 18 *Revenue.*

7. In the Discussion Paper the IASB and the FASB proposed using their existing definitions of revenue as the basis for developing a revenue recognition model, which they have now done. The definitions are based on changes in an entity's assets or liabilities and the IASB and FASB were seeking to clarify revenue recognition requirements by changing the focus of guidance from recognition based on transfer of risks and rewards to recognition based on changes in assets and liabilities. As a result, the proposals were not expected to result in significant change.

> *Note for the Boards:*
>
> *The Boards agreed with the proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability.*
>
> *However, the AASB was concerned that: (i) the IASB had missed an opportunity to evaluate whether fundamental change to the revenue definition might be warranted; and (ii) given the substantial investment in the revenue project, the IASB would be reluctant to reconsider the definition of revenue in the near future.*
>
> *The Boards expressed concern at the potentially narrow scope of the proposals in the Discussion Paper being limited to contracts with customers and recommended that the IASB clarify whether or not income arising other than from a contract with a customer could be described as revenue. The IASB has defined* revenue as *income arising in the course of an entity's ordinary activities which implies that revenue may arises from sources other than a contract with a customer.*

Scope

8. The proposed standard is intended to apply to all contracts with customers except:
    a) financial instrument contracts;
    b) lease contracts;
    c) insurance contracts within the scope of IFRS 4 *Insurance Contracts* (as a consequential amendment the IASB is proposing to amend references to revenue recognition and disclosure requirements to be consistent with the proposals in the Exposure Draft); and
    d) non-monetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange (e.g. swaps of similar items).

9. The proposed requirements would affect any entity that enters into contracts to provide goods or services that are an output of the entity's ordinary activities, unless those contracts are within the scope of another IFRSs. However, for some contracts (for example, many retail transactions), the IASB anticipates that the proposed requirements would have little, if any, effect.

10. A contract with a customer may be partially within the scope of the proposed standard and partially within the scope of other IFRSs. If the other IFRSs specify how to separate and/or initially measure any parts of the contract, an entity must first apply those separate and/measurement requirements. Otherwise, the entity is required to apply the proposed standard to separate and/or initially measure those parts of the contract.

> *Note for the Boards:*
>
> *The Discussion Paper did not address accounting for contracts partly within the scope of the proposed new revenue standard and partly within the scope of other IFRSs.*

11. In addition, the existing requirements for the recognition of a gain or loss on the sale of some non-financial assets that are not an output of the entity's ordinary activities (for example, property, plant and equipment or investment property) would be amended to be consistent with the proposed revenue recognition and measurement requirements. In the Exposure Draft the IASB is proposing (amongst others) the following consequential amendments to amend the requirements of IAS 16 *Property, Plant and Equipment,* IAS 38 *Intangible Assets* and IAS 40 *Investment Property.* The IASB is proposing to amend the requirements for determining the date of disposals and the measurement of consideration to be consistent with the proposals in the Exposure Draft. Consequently, an entity would derecognise an asset when the buyer obtains control of the asset, and recognise at that date a gain or loss equal to the difference between the transaction price and the carrying amount of the asset. The transaction price would be limited to the amounts that can be reasonably estimated at the date of transfer.

> *Note for the Boards:*
>
> *The Boards expressed concern at the potentially narrow scope of the proposals in the Discussion Paper being limited to contracts with customers and recommended that the IASB clarify whether or not income arising other than from a contract with a customer could be described as revenue. The IASB is now clarifying that profits or losses on the sale of property, plant and equipment etc. are presented net as gains or losses.*

Overview of the proposed standard

12. The Exposure Draft specifies the principles that an entity would apply to report useful information about the amount, timing and uncertainty of revenue and cash flows arising from its contracts to provide goods or services to customers. The proposed requirements also specify the accounting for some costs.

13. Similar to the existing IFRS guidance, the Exposure Draft proposes a model based on a contract with a customer, with revenue being recognised when goods and/or services are transferred to the customer. A contract is defined as "an agreement between two or more parties that creates enforceable rights and obligations." An entity is required to recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it receives, or expects to receive, in exchange for those goods or services.

14. Under the proposals an entity is required to:
   a) identify the contract(s) with a customer;
   b) identify the separate performance obligations in the contract;
   c) determine the transaction price;
   d) allocate the transaction price to the separate performance obligations; and
   e) recognise revenue when the entity satisfies each performance obligation.

15. The tables below provide a summary of the proposals in the Exposure Draft[2]. The 'Comments' column includes a combination of:
   a) AASB/FRSB comments on the IASB's Discussion Paper (also refer to agenda items 6.3 and 6.4 for copies of the FRSB and AASB comment letters respectively);
   b) selected FRSB comments on tentative decisions made by the IASB as it developed the Exposure Draft; and
   c) FRSB staff comments.

16. For noting, provided in memo 6.2 is FRSB staff's assessment of the potential impact of the IASB's proposals on current practice.

> *Note for the Boards:*
>
> Staff are seeking the views of the Boards as to whether they retain their original views or how their views have changed since the issuance of the Exposure Draft.

[2] The summary is largely based on the Deloitte Global Publication: Deloitte *IFRS in Focus: IASB Issues revenue recognition exposure draft* June 2010

Step 1: Identify the contract(s) with a customer		*Comments*
Identifying a contract	In most cases, an entity would apply the proposed requirements to a single contract. A contract is defined as an agreement between two ore more parties that creates enforceable rights and obligations. A contract exists only if: ▪ the contract has commercial substance; ▪ the parties approve the contract and are committed to satisfying their obligations; ▪ the entity can identify each party's enforceable rights; and ▪ the terms and manner of payment for can be identified. A contract does not exist if either party can terminate a wholly unperformed contract without penalty.	*The Boards agreed with the definition of a contract proposed in the Discussion Paper noting that it would suitably capture not only legal contracts but also in-substance contracts. The Discussion Paper did not include criteria for identifying a contract.*
Combining and segmenting contracts	There may be situations when an entity would combine two or more contracts as a single contract. According to the Exposure Draft, combining of contracts would be appropriate if the prices of those contracts are interdependent. Conversely, an entity may treat a single contract with a customer as two or more contracts if elements within the contract are priced independently of other elements.	*The Discussion Paper did not include discussion of the combining or segmenting of contracts.*
Contract modifications	A modification to a contract is accounted for as a part of the original contract if the price is interdependent with the original contract.	*Contract modifications were not addressed in the Discussion Paper.*

Step 2: Identify the separate performance obligation in the contract		*Comments*
Identification of separate performance obligations	A performance obligation is an enforceable promise (whether explicit or implicit) in a contract with a customer to transfer a good or service to the customer. Under the Exposure Draft an entity evaluates all goods and/or services promised in the contract to determine whether there are separate performance obligations. The proposals would require an entity to account separately for a good or service if it is *distinct*, meaning that the good or service either is sold separately in the customer's market or could be sold separately because it would be useful in itself or in conjunction with another product that is available separately.	*The Boards agreed with the proposed definition of a performance obligation.* *The Boards agreed that (i) basing performance obligations on contractual promises would enable those obligations to be determined objectively and verified; and (ii) treating implicit promises as performance obligations promotes consistent identification of components of contracts.*

Step 2: Identify the separate performance obligation in the contract		*Comments*
Types of goods and services	Goods or services include the following: ▪ goods produced or acquired for sale/resale; ▪ acting as an agent; ▪ standing ready to provide goods or services; ▪ developing an asset on behalf of a customer; ▪ granting licences, rights to use and options; and ▪ performing contractually agreed tasks.	*The Boards expressed concern that: (i) the explanation of the proposed model created the impression that goods and services are the only assets that may be transferred to customers; and (ii) the need to distinguish between goods and services (which could be difficult in practice) created the potential for divergent treatments of similar transactions depending on an entity's judgement as to whether it has provided a good or a service. The Boards considered that a robust principle for revenue recognition should not turn on the nature of the deliverable.*
Transferring goods or services at the same time	When an entity transfers goods or services to a customer at the same time, it is not necessary to apply the proposed requirements to each performance obligation separately if accounting for those performance obligations together would result in the same amount and timing of revenue recognition as if they were accounted for separately.	*The Boards agreed that performance obligations need to be accounted for separately only if they are satisfied at different times. However, the Boards were concerned that, despite only having to account for performance obligations satisfied at different times, the IASB's proposed would still required detailed record keeping for the purposes of assessing whether or not individual performance obligations are considered onerous.*

Step 3: Determine the transaction price		*Comments*
Determining a transaction price	The transaction price is the amount of consideration that an entity expects to receive from a customer in exchange for transferring goods or services. In many contracts, this is readily determinable as a fixed amount payable at or near the time of transfer of goods or services. If the amount of consideration is variable, an entity would recognise revenue from satisfying performance obligations only if the transaction price can be reasonably estimated. When determining the transaction price, an entity would consider the effects of the following: ▪ the time value of money; ▪ credit risk of the customer; ▪ non-cash consideration – measured at fair value; and ▪ consideration payable to the customer	*The Boards agreed that: (i) performance obligations should be measured initially at the transaction price; and (ii) the act of contracting with a customer should not of itself be treated as revenue generating.*
Time value of money	The time value of money should be considered when its effect is material. The adjustment for the time value of money would be applicable when a payment is due significantly before or after the transfer of goods and/or services. Therefore, it may become more common to adjust revenues for the time value of money when a prepayment is made by a customer or an extended credit period is granted to a customer.	*[Not addressed in the Discussion Paper]*
Credit risk of the customer	Under the proposals, the customer's credit risk affects how much revenue is recognised rather than whether revenue is recognised. An entity would adjust the transaction price to reflect the customer's credit risk using a probability-weighted approach.	*In discussing the progress of the IASB's Revenue project the FRSB noted that the IASB's tentative decision in respect of how to incorporate a customer's credit risk into the measurement of an entity's net contract position may not be consistent with the IASB's proposals in regards to impairment of financial assets.*

Step 3: Determine the transaction price		*Comments*
Variable consideration	When an entity has delivered goods or services, sometimes the amounts it will receive in the future are not fixed. Under the proposals, future variable consideration would be recognised using an 'expected value' approach, but only where that expected value can be measured reliably. Such an approach requires management to develop probabilities for each possible scenario based on the relevant past experience and assess as to whether it believes circumstances will change significantly. The transaction price can be reasonably estimated only if: ▪ the entity has experience with similar types of contracts; and ▪ the entity does not expect significant changes in circumstances.	*The Boards agreed that sometimes the transaction price may need to be estimated.* *The FRSB noted that more reliable and relevant measurement may result if a reporting entity is permitted to measure transactions prices based on portfolios of similar contracts rather than on a contract by contract basis.*
Consideration payable to the customer (e.g. slotting fees and discount coupons printed in a local newspaper)	If an entity pays consideration to a customer the entity must determine whether that amount is: ▪ a reduction of the transaction price (revenue) recognised at the later of (i) the entity transferring the promised goods or services to the customer; and (ii) the entity promising to pay the consideration (even if conditional upon a future event); ▪ a payment for a distinct good or service; or ▪ a combination of the above (in which case the entity must reduce the transaction price by the excess of consideration payable to the customer over the fair value of the goods or services received from the customer. If the entity cannot reasonably estimate the fair value of the goods or services received, the entity must account for the entire consideration payable to the customer as a reduction of the transaction price).	*The Boards agreed with the proposal that sales incentives offered within a contract with a customer give rise to performance obligations because the entity providing the sales incentives is promising to transfer to its customer an asset or provide future services. However, the Boards considered that sales incentives offered free of charge and independently of another transaction (e.g. retailer publishing a discount coupon in a national newspaper) do not give rise to performance obligations and should not be recognised in an entity's financial statements.* *The FRSB suggested that an entity should not recognise the distribution of the coupons in its financial statements and, when the vouchers are redeemed, the retailer should recognise the discount off the normal selling price of the products as a marketing expense.*

Step 4: Allocate the transaction price to separate performance obligations		*Comments*
Initial allocation of the transaction price	The Exposure Draft requires the transaction price to be allocated between distinct elements in proportion to the stand-alone selling price of each element. The best evidence of a stand-alone selling price is the observable price of a good or service that is sold separately. However, in situations where goods or services are not sold separately, the Exposure Draft would require an entity to develop an estimate based on a reasonable approach. Any discount to the aggregate of standalone selling prices is allocated strictly in proportion to the stand-alone selling price of each distinct good or service. Suitable estimation methods include the following: ▪ expected cost plus a margin approach; and ▪ adjusted market assessment approach – an entity could evaluate the market in which it sells goods or services and estimate the price that customers would be willing to pay and might refer to prices of competitors for similar goods or services adjusting those prices as necessary to reflect the entity's costs and margins.	*The Boards agreed that the transaction price should be allocated to performance obligations identified within a contract on the basis of the entity's selling price of the individual goods or services underlying those performance obligations. If an entity does not sell goods or provide services separately, the entity should estimate the stand-alone selling price for the purposes of allocating the transaction price to the identified performance obligations.*
Allocating subsequent changes in the transaction price	After contract inception, an entity shall allocate any changes in the transaction price to all performance obligations on the same basis as at contract inception. Amounts allocate to satisfied performance obligations must be recognised as revenue, or a reduction of revenue, in the period in which the transaction price changes.	*Adjustments to the transaction price subsequent to contract inception were not addressed in the Discussion Paper.*

Step 5: Recognise revenue when performance obligation is satisfied		*Comments*
Recognising allocated revenue/ satisfying a performance obligation *and* *Continuous transfer of goods or services*	Revenue is recognised when a good or service is transferred to a customer satisfying a performance obligation in the contract which is when the customer obtains control of the good or service. The amount of revenue is the amount of the transaction price allocated to the satisfied performance obligation. The principle is that "a customer obtains control of a good or service when the customer has the ability to direct the use of, and receive the benefit from, the good or service". A customer has obtained control if it has the present right to use the asset for its remaining economic life or to consume the asset in the customer's activities, together with the present right to obtain substantially all of the potential cash flows from that asset. The transfer of control of a product or service can be at a point in time or continuously. The Exposure Draft provides the following indicators for determining whether control has passed to the customer, but emphasises that none is individually determinative and that some will not always be relevant: ▪ the customer has an unconditional obligation to pay; ▪ the customer has legal title; ▪ the customer has physical possession; and ▪ the design or function of the good or service is customer-specific. When control is deemed to be transferred continuously, an entity must determine how to recognise revenue. According to the Exposure Draft, "an entity shall apply to that performance obligation one revenue recognition method that best depicts the transfer of goods or services to the customer. The entity shall apply that method consistently to similar performance obligations and in similar circumstances." The following are acceptable methods of recognising revenue: ▪ output methods that recognise revenue on the basis of units produced, units delivered, contract milestones, or surveys of work performed; ▪ input methods that recognise revenue on the basis of costs incurred, labour hours expended, or machine hours used; and ▪ methods based on the passage of time.	*[Note: Control in the IASB's project on consolidation and the conceptual framework project refers to power and returns rather than 'ability to direct' and 'benefits'. In the conceptual framework project an entity is considered to have control over another entity if it has the power to direct the activities of another entity to generate benefits for (or limit losses to) itself.]* *In commenting on the Discussion Paper the Boards were concerned that entities would not be able to recognise revenue as services were performed and may be precluded from recognising revenue until physical delivery of goods or services. The Boards suggested that, rather than determining whether control over promised goods or services has been transferred to a customer on the basis of physical delivery, it may be possible to determine that control has been transferred to a customer when both of the following criteria are met:* ▪ *the reporting entity has performed work in creating or acquiring the promised goods; and* ▪ *the reporting entity is unconditionally entitled to compensation for the work performed.* *Under this approach the customer's obligation to make payment that emerges as work is carried out is accompanied by a corresponding right of the customer to the work that the reporting entity has undertaken resulting in a continuous transfer of control of, or a right to, the work that has been performed by the reporting entity and the reporting entity generating revenue progressively as it performs.*

Step 5: Recognise revenue when performance obligation is satisfied		*Comments*
		Under the proposals, entities must assess whether the customer has obtained control of the product or service. The proposals may have a significant impact for entities that currently apply a percentage of completion model but the customer has neither physical possession of nor title to any work in progress. Entities may be required to recognise revenue when the product is completed and delivered to the customer. For example, this might affect entities that produce customer-specific reports, software or specialist equipment. *Under IAS 11 Construction Contracts and IFRIC 15 Agreements for the Construction of Real Estate, whether the design or function of the good or service is customer-specific determines if a contract is a construction contract and, therefore, whether revenue is recognised on a percentage of completion basis. Under the proposals, this factor will no longer be sufficient in and of itself and judgement will be required as to whether the customer has control of any work in progress. An illustrative example in the Exposure Draft indicates that control will have passed if the design or function is customer-specific and the customer also has the ability to take possession of the work in progress during manufacturing and engage another entity to complete the manufacturing.* *It is not immediately clear whether the customer's ability to take possession of any work in progress is an essential factor, or whether other factors might instead be sufficient.*

Onerous performance obligations		*Comments*
Onerous performance obligations	An entity would evaluate an individual performance obligation to determine whether it is onerous. A performance obligation would be onerous if the direct costs that would be incurred to satisfy the obligation are greater than the allocated transaction price. If so, a separate liability [and a corresponding expense] would be recognised for that individual performance obligation. Before an entity recognises a liability for an onerous performance obligation, it must recognise any impairment losses on related assets. At each subsequent reporting date, an entity must update the measurement of the onerous performance obligation using current estimates and recognise changes as an expense (or reduction of an expense).	*The Boards agreed that a performance obligation should be deemed onerous, and remeasured to the entity's expected cost of performance, if the expected cost of performance exceeds the performance obligation's carrying amount.* *The Boards agreed with the suggestion in the Discussion Paper that performance obligations within contracts with highly variable outcomes may require regular remeasurement, not only when the performance obligations become onerous.* *The Boards expressed concern about the practicality of applying the proposed requirement to identify separate performance obligations in cases where a 'whole-of-customer' approach is taken to a contract, such as is common with telecommunications contracts.* *Under current IFRSs, an entity evaluates the contract as a whole to determine whether it is onerous. If so, a provision is recognised for that onerous contract. Some entities choose to sell items at a loss to generate future profitable business. Under the proposals, any contract that includes such items will, at the date of signing, result in the recognition of an onerous performance obligation provision – even if those items are bundled with other profitable items so that the contract as a whole is profitable.*

Contract costs	*Comments*
Costs of obtaining a contract are recognised as expenses when incurred. If the costs incurred in fulfilling a contract are not eligible for capitalisation in accordance with other IFRSs, an entity recognises an asset only if those costs: ▪ relate directly to a contract (or a specific contract under negotiation); ▪ generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and ▪ are expected to be recovered.	*The Boards considered that there should not be a presumption that contract origination costs are to be expensed and it is not sufficient to leave their accounting treatment to be determined based on other IFRSs.*

Implementation guidance		*Comments*
Warranties	The proposals distinguish between a product warranty that provides coverage for latent defects and a warranty that covers faults that arise after the product is transferred. A latent defect is one that exists but is not apparent when the asset is transferred to the customer. A separate performance obligation would not be recognised for these types of product warranties; instead, revenue relating to the product itself is restricted to reflect the fact that a defective product has been supplied. Accordingly, an entity would need to estimate the amount of unsatisfied performance obligations relating to these types of warranties at the end of the reporting period based on the likelihood and extent of latent defects in the products it has sold to customers. An entity would not recognise revenue for products it expects to be required to replace and would not recognise the portion of revenue that can be attributed to components that the entity expects to be required to repair. A warranty that is provided to a customer that covers faults that arise after the product is transferred to the customer gives rise to a separate performance obligation. Therefore, a portion of the transaction price should be allocated by the entity to that warranty performance obligation. Under current IFRSs, warranties are often recorded as a liability at inception of the contract on the basis of the estimated costs to repair or replace the product. Under the Exposure Draft, revenue would instead be deferred and recognised on an appropriate basis over the warranty period.	*In commenting on the Discussion Paper the Boards agreed that an entity's obligation to accept returned goods and refund the customer's consideration should be a performance obligation (rather than an expense) and should be treated like an insurance contract as revenue generating activity.* *In discussing the progress of the IASB's Revenue project the FRSB noted the following:* ▪ *It is doubtful whether or not, in practice, it would be beneficial or even possible to distinguish between repair under warranty of latent defects and repair under warranty of defects that arise subsequent to the sale of goods.* ▪ *It is unclear what the IASB is proposing and what it is intending to achieve with its proposed accounting for rights to return goods and warranties. On the one hand, it appears as though the IASB's tentative decisions have little practical effect. It appears that both liabilities will be measured in the same way but it will be necessary to use different descriptions to distinguish between liabilities for income in advance and liabilities for performance obligations in respect of sales not yet completed. On the other hand, the tentative decisions seem to imply that there should be a different measurement basis applied.* ▪ *The IASB's tentative decisions could result in the presentation of a revenue number that does not represent the gross revenue earned by an entity. The gross revenue amount provides useful information to users.* *Based on correspondence with IASB staff:* ▪ *The failed sale approach [in the IASB staff view] should be more intuitive and simpler to apply to some warranties than the separate performance obligation approach proposed in the Discussion Paper. In particular, entities would not have to estimate the standalone selling price of such warranties - which are never sold separately. Rather, entities would only need to determine the proportion of performance obligations that have not yet been satisfied. Also, most believe that, if an entity has sold 10 products but expects 1 product to be returned for a refund, it would be more useful to present in the income statement revenue from 9 sales, rather than to record 10 sales and an expense for the refund obligation*

Implementation guidance		*Comments*
	[A law requiring an entity to pay compensation for damages does not give rise to a performance obligation. The entity accounts for such a liability under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*]	▪ *It is not intended that warranty obligations be measured in accordance with IAS 37. For both types of warranty (latent defect or service type), revenue is deferred. However, for the one type of warranty (warranty for latent defects) the entity is not required to measure the warranty itself but rather measures the unsatisfied performance obligation to provide the good.* *Regarding a warranty for latent* defects:* ▪ *If the entity will be required to replace defective assets, it does not recognise revenue for those assets. The unsatisfied performance obligation is measured at the amount of the customer consideration allocated to it.* ▪ *If the entity will be required to repair defective assets (eg a house), it does not recognise the portion of revenue that can be attributed to components that need to be replaced in the repair process. In concept that would require the entity to determine the standalone selling price of the goods and services to be replaced and allocate the transaction price accordingly. However, in practice, the entity might be able to achieve the same outcome by estimating the costs and adding a margin.* **Note: The word 'latent' is used to avoid implying that the entity knows about the defect. It is not intended to imply that the entity sells a product with a known defect, an entity would generally be unlikely to sell products with known defects.*

Implementation guidance		*Comments*
Rights of return	An entity would not recognise revenue for goods expected to be returned. Instead, a liability would be recognised for the expected amount of returns and that liability would be updated for any changes in estimate. Additionally, an asset and a corresponding credit to cost of sales would be recognised for the right of recovery from the customer. [If the probability of a refund cannot be estimated, the entity cannot recognise revenue. The consideration is recognised as a refund liability.]	*The Boards agreed with the proposal in the Discussion Paper that an entity's obligation to accept returned goods and refund the customer's consideration should be a performance obligation (rather than an expense) consistent with a standalone guarantee (such as an insurance contract) being treated as a revenue generating activity. The Boards considered that treating rights of return as options to unwind a contract requiring an entity to defer revenue recognition inappropriately would imply that the contract with the customer has not resulted in anything of substance.*
Licences and rights to use	[Intellectual property includes all of the following: ▪ software and technology; ▪ motion pictures, music etc; ▪ franchises; ▪ patents, trademarks and copyrights; and ▪ other intangible assets.] A licence that transfers control of the entire licensed intellectual property to the customer (e.g. an exclusive licence for the entire economic life) would be treated as a sale. An entity that licenses the use of its intellectual property but does not transfer control of the entire licensed intellectual property to the customer (e.g. a licence for less than its economic life) would need to determine whether the licence is exclusive or non-exclusive. For exclusive licences, the performance obligation would be extinguished over time so revenue would be recognised over the term of the licence. For non-exclusive licences, the performance obligation would relate only to transfer of the licence and therefore revenue would often be recognised at the date the customer is able to use the licence.	*In discussing progress of the IASB's revenue project the FRSB noted that the IASB should consider revenue recognition under a licensing contract in the situation where an entity has not recognised an asset for the intangible asset that is the subject of the license. The FRSB considered that this situation is likely to be common the public sector but could also be common in the private sector.*

Implementation guidance		*Comments*
Customer options to acquire additional goods (e.g. customer loyalty points, volume rebates and vouchers offering discounts on further purchases)	If a customer's option to acquire additional goods or services provides the customer with a material right that the customer would not receive without entering into that contract (eg incremental volume rebate/discount and customer loyalty points) the customer in effect pays the entity in advance for future goods and service and the entity recognises revenue when those future goods or services are transferred or when the option expires. If a customer has the option to acquire an additional good or service at a price that is within the range of prices typically charged for those good or services, that option does not provide the customer with a material right.	*The Boards agreed with the proposal in the Discussion Paper that sales incentives offered within a contract with a customer give rise to performance obligations. This is because the entity providing the sales incentives is promising to transfer to its customer an asset or provide future services. However, the Boards considered that sales incentives offered free of charge and independently of another transaction do not give rise to performance obligations and should not be recognised in an entity's financial statements (except where the redemption of the vouchers will result in products or services being sold at a loss).* *The FRSB suggested that volume rebates could be considered to be a reduction in the sales prices to be dealt with through measurement of revenue. This is because the future delivery of goods is not a performance obligation until the retailer actually places an order for more goods.*
Non-refundable upfront fees	An entity must assess whether the upfront fee relates to the transfer of a promised good or service. In many cases, even though a non-refundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfil the contract, that activity does not result in the transfer of a promised good or service to the customer and is an advance payment for future goods or services recognised as revenue only when those future goods or services are provided. The revenue recognition period could extend beyond the initial contract period if the customer has an option to renew and that option provides the customer with a material right.	*Accounting for non-refundable upfront fees was not addressed in the Discussion Paper.*

Disclosures	*Comments*
The Exposure Draft proposes extensive disclosure requirements on various aspects of revenue recognition and contracts with customers.	*Disclosure requirements were not addressed in the Discussion Paper.*

Transition	*Comments*
The Exposure Draft would require full retrospective application. The IASB tentatively decided that first time adopters of IFRSs would be permitted to adopt the new standard early but has yet to decide whether early adoption would be permitted for existing IFRS preparers. The IASB and the FASB are expected to issue a separate consultation document later this year seeking stakeholder input about effective dates and transition methods on a range of projects.	*Transition requirements were not addressed in the Discussion Paper.*