

Contents

Introduction

Topic 1 — Allocation of the Transaction Price for Discounts and Variable Consideration

Topic 2 — Material Rights

Topic 3 — Consideration Payable to a Customer

Topic 4 — Partially Satisfying Performance Obligations Before Identifying the Contract

Topic 5 — Warranties

Topic 6 — Significant Financing Components

Topic 7 — Whether Contributions Are Within the Scope of the New Revenue Standard

Topic 8 — Series of Distinct Goods or Services

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IASB and FASB Joint Transition Resource Group for Revenue Recognition

March 2015

This publication summarizes the March meeting of the IASB and FASB joint revenue transition resource group (TRG).

Introduction

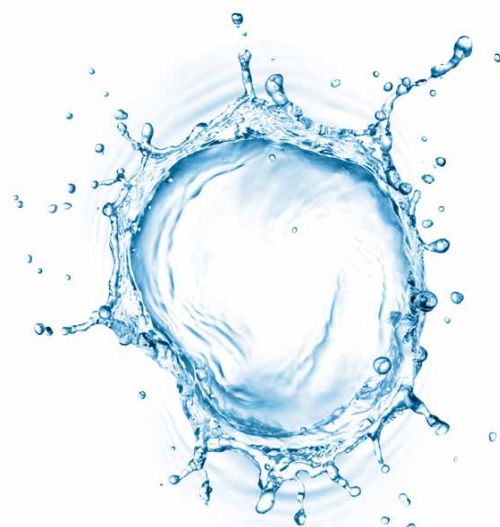
The purpose of the TRG is not to issue guidance but instead to seek feedback on potential issues related to the implementation of IFRS 15 *Revenue from Contracts with Customers* (the “new revenue standard”). By analysing and discussing potential implementation issues, the TRG will help the boards determine whether they need to take additional action, such as providing clarification or issuing other guidance. The TRG comprises financial statement preparers, auditors, and users from “a wide spectrum of industries, geographical locations and public and private organizations,” and board members of the IASB and FASB attend the TRG’s meetings. Representatives from the SEC, PCAOB, IOSCO, and AICPA are also invited to observe the meetings.

See the IASB’s [Website](#) for more information about the TRG, including [meeting materials](#) further describing the topics discussed below.

The TRG generally agreed with the IASB and FASB staffs’ analysis, conclusions, or recommendations regarding Topics 1, 2, 4, and 6. TRG members did not reach general agreement on the issues related to Topics 3 and 8, and it is likely that those issues will be addressed at a future TRG meeting. Topics 5 and 7 were not sources of much discussion because they are educational and are not intended to solicit views on recommendations or conclusions.

The TRG’s next meeting is scheduled for July 13, 2015.

Editor’s Note: On 1 April 2015, the FASB tentatively agreed to delay the effective date of the new revenue standard and to permit early adoption by entities reporting under U.S. GAAP. Public and private entities would have an additional year in which to continue their implementation efforts. Further, entities would be permitted to early adopt as of the original effective date. At the time of writing, it is expected that the IASB will consider during April 2015 whether to delay the effective date of IFRS 15.



For more information please see the following websites:

www.iasplus.com

www.deloitte.ca

Topic 1 — Allocation of the Transaction Price for Discounts and Variable Consideration

Background

The new revenue standard includes guidance on allocating discounts to only one or some, but not all, performance obligations (paragraph 82 of IFRS 15), which differs from guidance on allocating variable consideration to one or some, but not all, performance obligations (paragraphs 85 and 86 of IFRS 15). Because discounts may be variable consideration (e.g., the new revenue standard cites discounts as examples of variable consideration), stakeholders have questioned which guidance should be applied when an entity's contract with a customer includes a discount.

The IASB and FASB staffs noted that stakeholders have expressed three views on this topic:

- **View A** — An entity would first determine whether a discount is variable consideration. If the entity concludes that the discount is variable consideration, it would apply the variable consideration allocation guidance if the related criteria are met. Otherwise, the entity would look to the discount allocation guidance to determine how to allocate the discount.
- **View B** — Regardless of whether a discount is fixed or variable, an entity would consider only the discount allocation guidance and allocate the discount accordingly.
- **View C** — An entity would use judgment and apply either the discount allocation guidance or the variable consideration allocation guidance depending on the facts and circumstances.

The staffs concluded that View A is the only view supported under the new revenue standard because they believed that paragraph 86 of IFRS 15 establishes a hierarchy that requires an entity to identify, and allocate variable consideration to, performance obligations before applying other guidance (e.g., the guidance on allocating a discount).

See [TRG Agenda Paper 31](#) for additional details.

Summary

TRG members generally supported the staffs' recommendation.

Topic 2 — Material Rights

Background

The new revenue standard includes implementation guidance that requires an entity to assess whether an option for future goods or services provides a customer with a material right (paragraphs 26 and B40 of IFRS 15) and therefore should be accounted for as a performance obligation. If the option provides a customer with a material right, the entity should allocate a portion of the consideration to the material right and recognize revenue when the underlying "future goods or services are transferred or when the option expires" (paragraph B40 of IFRS 15). Because forms of customer options differ (e.g., customer awards, sales incentives, future discounts), stakeholders have raised various implementation issues, including the following:

- **Issue 1: Accounting for a customer's exercise of a material right** — The IASB and FASB staffs noted that they are aware of three views on how an entity should account for the exercise. Under "View A," an entity would account for the exercise as a change in the contract's transaction price (paragraphs 87 through 90 of IFRS 15) (i.e., a continuation of the contract, whereby the additional consideration would be allocated to the material right). Under "View B," the exercise would be accounted for as a contract modification (paragraphs 18 through 21 of IFRS 15) which may require reallocation of consideration between existing and future performance obligations. Proponents of "View C" maintain that an entity should account for the exercise as variable consideration (i.e., at the inception of the initial contract, the entity would estimate the likelihood of the exercise of the option to determine the amount of variable consideration, subject to the constraint, to include in the transaction price). The staffs rejected View C because they did not believe that it is supported by the new revenue standard (specifically in light of the discussion in paragraph BC186 of the standard's basis for conclusions). They noted that either View A or View B is reasonable but emphasized that because material rights can vary significantly, an entity would need to use judgment to determine which alternative to apply.
- **Issue 2: How to evaluate material rights for the existence of significant financing components** — The staffs noted that the new revenue standard requires an entity to evaluate the significant financing component when determining the transaction price and that such an evaluation would include an assessment of material rights. While the guidance notes certain instances in which a significant financing component is not present (paragraph 62(a) of IFRS 15 states that a significant financing component does not exist when the "customer paid

for the goods or services in advance, and the timing of the transfer of those goods or services is at the discretion of the customer” and paragraph 63 of IFRS 15 provides that “[a]s a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less”), a significant financing component may exist as a result of providing a material right if certain factors are present.

See [Topic 6 — Significant Financing Components](#) below for a discussion of factors that may indicate more broadly whether a significant financing component exists.

- **Issue 3: Determining the period over which an entity should recognize a nonrefundable up-front fee (e.g., a one-time activation fee in a month-to-month service contract under which the entity has not committed to future pricing)** (This issue was also discussed at the October 2014 TRG meeting) — The staffs stated that the determination of whether an entity should recognize a nonrefundable up-front fee over the contract period (one month in the above example) or over the expected service period (i.e., the life of the customer relationship) depends on whether the up-front fee provides the customer with a material right. In the staffs’ view, the nonrefundable up-front fee should be recognized over the contract period if the entity concludes that the fee does not provide a material right. Conversely, if the nonrefundable up-front fee provides the customer with a material right, the fee should be recognized over the expected service period. The staffs also stated that an entity should consider both qualitative and quantitative factors to determine whether a nonrefundable up-front fee provides the customer with a material right. Such factors include (1) the entity’s historical renewal experience, (2) whether the customer could obtain substantially equivalent services from another service provider without paying a similar nonrefundable up-front fee, and (3) the comparability of the renewal rate to the amount that a new customer would be required to pay.

For additional information, see [TRG Agenda Paper 32](#).

Summary

Although the TRG generally agreed with the staffs’ analysis, conclusions, and recommendations with respect to Issues 1, 2, and 3, it primarily discussed Issue 1, specifically View A (under which a customer’s exercise of a material right would be accounted for as a change in the transaction price) and View B (under which the exercise would be accounted for as a contract modification). Many TRG members expressed a preference for View A because they believed that it is consistent with current practice, leads to a logical outcome, and may be more practical to apply. However, TRG members did not oppose View B because they understood how it could be a viable alternative under the new revenue standard. Although TRG members acknowledged that allowing two alternatives could result in inconsistent application (e.g., from a broad policy election), they noted that any election should be consistently applied to similar types of transactions. Further, many TRG members believed that the accounting outcomes under View A would often be similar to those under View B because under either view, the underlying goods or services associated with the material right are likely to be distinct performance obligations (i.e., since they are optional under the initial contract).



Topic 3 — Consideration Payable to a Customer

Background

In addition to guidance on the recognition, measurement, and presentation of consideration payable to a customer (paragraphs 70 through 72 of IFRS 15) the new revenue standard contains guidance on variable consideration (paragraph 50 of IFRS 15) under which an entity is required to estimate the amount of variable consideration and include that amount in the transaction price. Although the standard's variable consideration guidance would arguably apply to consideration payable to a customer if such consideration is variable, some stakeholders believe that a requirement to include variable consideration payable to a customer in the transaction price may be inconsistent with the requirement to delay the recognition of consideration payable to a customer until the entity pays or promises to pay. Further, the IASB and FASB staffs noted that there are different interpretations regarding (1) which entities meet the definition of a customer and (2) what payments to a customer could result in a reduction of revenue.

Accordingly, the staffs performed an analysis of the following issues:

- **Issue 1: *Assessing which payments to a customer are within the scope of the guidance on consideration payable to a customer*** — In evaluating this issue, the staffs indicated there are three prevailing interpretations: (1) an entity should assess **all** consideration payable (broadly, all payments) to a customer ("Interpretation A"); (2) an entity should assess only consideration payable to a customer under a contract with the customer (or combined contracts) ("Interpretation B"); and (3) an entity should assess only consideration payable to a customer under a contract with the customer (or combined contracts) and consideration payable to customers in the distribution chain of the entity's customer ("Interpretation C"). The staffs concluded that Interpretation A is the only interpretation supported under the new revenue standard because the boards acknowledge in paragraph BC257 of the standard's basis for conclusions that the receipt of consideration from a customer and the payment of consideration to a customer can be linked even if they are unconnected events.
- **Issue 2: *Determining whether the guidance on consideration payable to a customer applies only to customers in the distribution chain or more broadly to any customer of an entity's customer*** — In the staffs' view, the phrase "for example" in paragraph BC255 does not indicate that the guidance on consideration payable to a customer should be applied to a customer's customer that is not in the

distribution chain. The staffs noted that "[t]hose in the distribution chain are the customer's customers" and that "the phrase customer's customer is a plain English way to describe the concept."

- **Issue 3: *Timing of recognition of consideration payable to a customer*** — The staffs expressed their belief that the variable consideration guidance under the new revenue standard does not conflict with the standard's guidance on consideration payable to a customer. They concluded that if the consideration payable to a customer is variable, the guidance on variable consideration should be applied. Conversely, they determined that if such consideration is not variable, the guidance on consideration payable to a customer is applicable.

See [TRG Agenda Paper 28](#) for additional information.

Summary

Issue 1 generated considerable debate among TRG members, with some members agreeing with the staffs' recommendation of Interpretation A and others viewing Interpretation B as the appropriate conclusion. However, TRG members generally agreed that an entity should evaluate a payment to a customer (or to a customer's customer), particularly when no goods or services have been transferred, to determine the commercial substance of the payment and whether the payment is linked (economically) to a revenue contract with the customer. Accordingly, TRG members generally agreed that the staffs should seek to reconcile the Issue 1 views articulated in TRG Agenda Paper 28 rather than recommend amendments to the new revenue standard.

On Issues 2 and 3, the TRG did not agree, and FASB members indicated that the Board and its staff should evaluate feedback from TRG members to determine next steps (most likely at a future TRG meeting), including whether "workable solutions" are possible under the new revenue standard or whether a change to the standard is required. Concerns about Issue 2 were primarily related to the identification of a customer, particularly for an agent that may have more than one customer (i.e., the principal and end customer in a revenue transaction); but TRG members generally agreed that an entity should evaluate a payment to a customer to determine whether the payment should be linked to a contract (as they did with respect to Issue 1). For Issue 3, the crux of the TRG's debate was whether the appropriate timing for recognition of an adjustment to the transaction price is (1) the communication date (e.g., when a customer is informed of a planned "coupon drop"), (2) the management approval date (e.g., when management with relevant authority approves a planned coupon drop), or (3) determined in accordance with the guidance on constraining variable consideration.

Topic 4 — Partially Satisfying Performance Obligations Before Identifying the Contract

Background

Entities sometimes begin activities on a specific anticipated contract with their customer before (1) they agree to the contract or (2) the contract meets the criteria in step 1 of the new revenue standard. The IASB and FASB staffs refer to the date on which the contract meets the step 1 criteria as the “contract establishment date” (CED) and refer to activities performed before the CED as “pre-CED activities”. (In paragraph 3 of TRG Agenda Paper 33, the staffs noted that pre-CED activities may include (1) “administrative tasks that neither result in the transfer of a good or service to the customer, nor fulfil the anticipated contract”; (2) “activities to fulfil the anticipated contract but which do not result in the transfer of a good or service, such as set-up costs”; or (3) “activities that transfer a good or service to the customer at or subsequent to the CED”.)

The staffs noted that stakeholders have identified two issues with respect to pre-CED activities:

- **Issue 1: How to recognize revenue from pre-CED activities** — Once the criteria in step 1 have been met, stakeholders have suggested that entities should recognize revenue for pre-CED activities either (1) on a cumulative catch-up basis (i.e., record revenue as of the CED for all satisfied or partially satisfied performance obligations) or (2) prospectively (i.e., record revenue for performance that occurred before the CED as the remaining performance obligations are satisfied). The staffs recommended the first alternative because they believe that it is more consistent with the new revenue standard’s core principle.
- **Issue 2: How to account for certain fulfillment costs incurred before the CED** — The staffs noted three potential alternatives identified by stakeholders:
 1. **Alternative A.** Such costs are capitalised as costs to fulfil an anticipated contract. These costs would be expensed immediately at the CED if they relate to progress made to date because the goods or services constituting a performance obligation have already been transferred to the customer. The remaining asset would be amortised over the period over which the goods or services to which the asset relates will be transferred to the customer.
 2. **Alternative B.** Such costs are capitalised as costs to fulfil an anticipated contract and amortised as the entity transfers the remaining goods or services under the contract, ie on a prospective basis.
 3. **Alternative C.** Such costs cannot be capitalised as costs to fulfil an anticipated contract because

they relate to progress made prior to obtaining the contract and not to satisfying performance obligations in the future. Therefore, such costs should be expensed as incurred unless they qualify for capitalisation under other guidance (eg inventory guidance).

The staffs noted that they did not consider Alternative B for prospective treatment because they did not recommend prospective accounting for Issue 1. The staffs recommended Alternative A because this “would result in the same cumulative recognition of costs and hence margin at the CED and in future periods as a contract that had met the criteria [for being a contract] from the inception of the contract. The two contracts will be identical and hence economically equivalent from the CED.”

For more information, see [TRG Agenda Paper 33](#).

Summary

TRG members generally agreed with the staffs’ recommendations

Topic 5 — Warranties

Background

The new revenue standard provides guidance on when an entity should account for a warranty as a performance obligation (e.g., if a customer has a choice to purchase a warranty or the warranty provides a service in addition to the assurance that the product complies with agreed-upon specifications). If the warranty is a performance obligation, the entity would account for the warranty by allocating a portion of the transaction price to that performance obligation. (paragraphs 73 through 86 of IFRS 15). The guidance includes three factors that the entity would consider in making such a determination: (1) whether the warranty is required by law, (2) the length of the coverage period, and (3) the nature of the tasks that are promised (paragraph B31 of IFRS 15).

Questions continually arise about how an entity would determine whether a product warranty that is not separately priced is a performance obligation (i.e., whether the warranty represents a service rather than a guarantee of the product’s intended functionality). For illustrative purposes, the IASB and FASB staffs discussed an example in which a luggage company provides a lifetime warranty to repair any damage to the luggage free of charge and noted that such a warranty would be a separate performance obligation because the company agreed to fix repairs for any damage (i.e., repairs extend beyond those that fix defects preventing the luggage from functioning as intended).

The staffs noted that the luggage example “illustrates a

relatively straightforward set of facts and circumstances that demonstrate an instance of when a warranty provides a service” and further observed that the conclusion for other warranty arrangements may be less clear. Accordingly, the staffs reiterated that an entity will need to assess the substance of the promises in a warranty arrangement and exercise judgment on the basis of the entity’s specific facts and circumstances.

For additional details, see [TRG Agenda Paper 29](#).

Summary

TRG members generally agreed with the staffs’ conclusion for the fact pattern presented in TRG Agenda Paper 29. Some of the discussion focused on the duration of the warranty (i.e., the lifetime warranty in the luggage company example), but staff members reiterated that while duration may be an indicator of whether a warranty is a separate performance obligation, it is not determinative. The staff further reiterated that the paper’s main purpose was educational — that is, its primary aim was to counter the claim made by some stakeholders that “nothing has changed from current practice” and to demonstrate that an entity would need to use judgment in determining whether there are additional performance obligations to which the transaction price should be allocated.

Topic 6 — Significant Financing Components

Background

Under step 3 of the new revenue recognition model, an entity may need to include a significant financing component in its determination of the transaction price. The new standard notes the need for an entity to assess relevant facts and circumstances, including whether there is a difference “between the amount of promised consideration and the cash selling price of the promised goods or services.” (paragraph 61 of IFRS 15). Further, the standard notes three factors for which such a difference would not be attributable to a significant financing component (paragraph 62 of IFRS 15). The IASB and FASB staffs have been informed of the following stakeholder concerns about:

- *How broadly to interpret the factor in paragraph 62(c) of IFRS 15* — The guidance states that “the difference between the promised consideration and the cash selling price of the good or service arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract”. The staffs noted two prevailing

views. Under one such view, the factor should be interpreted narrowly (i.e., very few reasons would be supportable). Under the other view, the factor should be applied broadly to require an entity to consider the intent of the payment terms (i.e., whether the terms were intended as financing or for other reasons, such as customer convenience, retainer fees, and perceived value by the customer). Rather than recommending one of the views, the staffs noted that the views are at “opposite ends of the spectrum” and that the boards’ intent is most likely something in between these views. The staffs noted that determining whether a contract with a customer includes a significant financing component will require judgment because differences between the cash selling price and the promised consideration and between the timing of the transfer of goods and the timing of the receipt of payment “are not necessarily indicative of a significant financing component.”

- *How to apply the guidance when the promised consideration is equal to the cash selling price* — The staffs again reiterated the need for entities to use judgment and stated that an entity should not automatically presume that no significant financing component exists if the list price, cash selling price, and promised consideration are the same. Further, a difference in those amounts does not create a presumption that a significant financing component exists; rather, it would require an evaluation.
- *Whether the new standard precludes an entity from accounting for financing components that are not significant* — The staffs did not envision that entities would account for insignificant financing components but indicated that entities are not precluded from doing so.
- *Whether the practical expedient in paragraph 63 of IFRS 15 can be applied when there is a single payment stream for multiple performance obligations* — The guidance states that “as a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less”. — The staffs cited an example of a two-year customer contract under which an entity delivers a device and provides a service. They discussed two alternative views on determining whether the practical expedient applies in this situation (i.e., determining the period between the transfer of goods or services and the receipt of payment). Under “View A,” an entity would allocate the monthly consideration only to the first item delivered (i.e., the device in the example). Under “View B,” an entity would proportionately allocate

the monthly consideration to the device and services. For the example, the staffs indicated that View B is appropriate.

- *How to calculate interest in arrangements involving a significant financing component* — The staffs did not make recommendations; rather, they noted that the guidance does not explicitly address subsequent measurement, but entities should apply the guidance in IFRS 9 *Financial Instruments*. Further, they pointed to illustrative examples in the new revenue standard (examples 26 and 29) as guidance for entities to consider.
- *How to apply the significant financing component guidance when a contract with a customer includes multiple performance obligations* — The staffs expressed their belief that analogizing to the discount guidance in the new revenue standard is reasonable. They noted that “it might be possible to determine that a significant financing component relates specifically to one (or some) of the performance obligations” and added that “attribution of a financing component to one (or some) of the performance obligations will require the use of judgment.”

For more information, see [TRG Agenda Paper 30](#).

Summary

TRG members generally agreed with the staffs’ analysis of all issues noted in TRG Agenda Paper 30 but focused their discussion on the first two issues, regarding which they noted that “bright lines” were not intended in the application of the guidance. That is, TRG members agreed that the guidance should not contain a rebuttable presumption that an entity would need to overcome (e.g., regarding the existence or nonexistence of a significant financing component); rather, an entity should be allowed to use judgment to evaluate the facts and circumstances of a transaction. TRG members also agreed that these two issues (1) seem more closely related to advance payments than to payments made in arrears and (2) apply to other types of advance payments (i.e., not only to the activation fees cited in the example in TRG Agenda Paper 30). The staff agreed to make related interpretive clarifications in the March 2015 TRG meeting summary and to clarify paragraph 26 of TRG Agenda Paper 30. This update to paragraph 26 is intended to convey the notion that while an entity’s list price may equal the cash consideration, the list price may not reflect the cash selling price and if such a difference exists, it would need to be evaluated.

In addition, some TRG members debated the fourth issue (regarding the application of the practical expedient to a single payment stream comprising multiple performance obligations). Of the TRG members who participated in the discussion, most believed View

B to be the appropriate conclusion; but some argued that View A is also acceptable, and some suggested following the contractual terms if stated.

Topic 7 — Whether Contributions Are Within the Scope of the New Revenue Standard

Background

Contributions (which are defined as non-reciprocal transfers to a not-for-profit entity and are distinguishable from exchange transactions, which are reciprocal transfers) are not explicitly excluded from the scope of the new revenue standard. As a result, some stakeholders have questioned whether contributions are within the scope of the standard. The staff affirmed its belief that because contributions are nonreciprocal transfers (i.e., they do not involve the transfer of goods or services to a customer), they are outside the scope of the new guidance.

See [TRG Agenda Paper 26](#) for more information.

Summary

TRG members generally agreed that nonreciprocal contributions are not within the scope of the new revenue standard; however, TRG members noted that if a not-for-profit entity transfers a good or service for part or all of a contribution (i.e., a reciprocal transfer), such a reciprocal transfer should be accounted for under ASC 606. TRG members in the United States also agreed with FASB board and staff members not to amend ASC 606 to add another scope exception and agreed with a FASB board member’s suggestion that the AICPA could evaluate whether to include an interpretive clarification in its nonauthoritative industry guidance.

Topic 8 — Series of Distinct Goods or Services

Background

Unlike current revenue guidance, the new revenue standard includes the concept of a series of distinct goods or services that are substantially the same and have the same pattern of transfer (the “series provision”) (paragraphs 22 and 23 of IFRS 15). This concept was introduced to promote simplicity and consistency in application (paragraph BC113 of the new revenue standard’s basis for conclusions).

The IASB and FASB staffs noted that an entity may determine that goods and services constitute a single performance obligation if (1) they are “bundled” together because they are not distinct or (2) they are distinct but meet the criteria that require the entity to account for them as a series (and thus as a single performance obligation). The staffs further noted that a single performance obligation that comprises a series of distinct goods or services rather than a bundle of

goods or services that are not distinct affects (1) how variable consideration is allocated, (2) whether contract modifications are accounted for on a cumulative catch-up or prospective basis, and (3) how changes in the transaction price are treated. Because of the potential implications associated with whether goods or services are determined to be a series, stakeholders have raised questions about the following:

- *Whether goods must be delivered (or services must be performed) consecutively for an entity to apply the series provision* — The staffs indicated that an entity should look to the series provision criteria in paragraph 23 of IFRS 15 to determine whether the goods or services are a series of distinct goods or services for which the entity is not explicitly required to identify a consecutive pattern of performance. Further, while the term “consecutively” is used in the new revenue standard’s basis for conclusions, the staffs noted that they “do not think whether or not the pattern of performance is consecutive is determinative [of] whether the series provision applies.” That is, goods or services do not need to be transferred consecutively to qualify as a series of distinct goods or services under the new revenue standard.
- *Whether the accounting result for the series of distinct goods or services as a single performance obligation needs to be the same as if each underlying good or service were accounted for as a separate performance obligation* — The staffs noted that they do not believe that the accounting result needs to be “substantially the same.” Further, the staffs stated that “such a requirement would almost certainly make it more difficult for entities to meet the requirement, and since the series provision is not optional, it likely would require entities to undertake a ‘with and without’ type analysis in a large number of circumstances to prove whether the series provision applies or not.”

See [TRG Agenda Paper 27](#) for additional information.

Summary

TRG members generally agreed with the staffs’ conclusions in TRG Agenda Paper 27. However, TRG members discussed a seeming contradiction that while the series literature was meant to simplify accounting (akin to a practical expedient), it is mandatory if an entity meets the criteria.

Treating performance obligations as a series may result in different accounting (as noted in the background discussion above). As a result, certain TRG members questioned whether the guidance should be mandatory or whether it may be better to have a practical expedient.



Key contacts

Ontario

Sean Morrison

Partner
416-601-6296
seamorrison@deloitte.ca

Cindy Veinot

Partner
416-643-8752
cveinot@deloitte.ca

Mark Wayland

Partner
416-601-6074
mawayland@deloitte.ca

Quebec

Nick Capanna

Partner
514-393-5137
ncapanna@deloitte.ca

Maryse Vendette

Partner
514-393-5163
mvendette@deloitte.ca

Prairies

Steve Aubin

Partner
403-503-1328
saubin@deloitte.ca

Atlantic

Geoffrey Cochrane

Partner
709-758-5091
gcochrane@deloitte.ca

B.C

Kari Lockhart

Senior Manager
604-640-4910
klockhart@deloitte.ca

IFRS centres of excellence

Americas

Karen Higgins

Canada
ifrs@deloitte.ca

Fermin del Valle

LATCO
ifrs-LATCO@deloitte.com

Robert Uhl

United States
iasplus-us@deloitte.com

Asia-Pacific

Anna Crawford

Australia
ifrs@deloitte.com.au

Stephen Taylor

China
ifrs@deloitte.com.cn

Shinya Iwasaki

Japan
ifrs@tohatsu.co.jp

Shariq Barmaky

Singapore
ifrs-sg@deloitte.com

Europe-Africa

Thomas Carlier

Belgium
ifrs-belgium@deloitte.com

Andreas Barckow

Germany
ifrs@deloitte.de

Ralph Ter Hoeven

Netherlands
ifrs@deloitte.nl

Cleber Custodio

Spain
ifrs@deloitte.es

Jan Peter Larsen

Denmark
ifrs@deloitte.dk

Massimiliano Semprini

Italy
ifrs-it@deloitte.it

Michael Raikhman

Russia
ifrs@deloitte.ru

Elizabeth Chrispin

United Kingdom
deloitteifrs@deloitte.co.ukl

Laurence Rivat

France
ifrs@deloitte.fr

Eddy Termaten

Luxembourg
ifrs@deloitte.lu

Nita Ranchod

South Africa
ifrs@deloitte.co.za

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