

Revenue from Contracts with Customers

Comments to AASB by 24 September 2010



Australian Government

**Australian Accounting
Standards Board**

Commenting on this AASB Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 24 September 2010. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 22 October 2010. Comments should be addressed to:

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Respondents to the IASB are asked to send their comments electronically through the 'Open to Comment' page on the IASB website (www.iasb.org)

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chairman of the AASB agrees to those submissions being treated as confidential. The latter will only occur if the public interest warrants such treatment.

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AASB REQUEST FOR COMMENTS

In light of the Australian Accounting Standards Board's (AASB's) policy of incorporating International Financial Reporting Standards (IFRSs) into Australian Accounting Standards, the AASB is inviting comments on:

- (a) any of the proposals in the attached International Accounting Standards Board (IASB) Exposure Draft, including the specific questions on the proposals as listed in the Invitation to Comment section of the attached IASB Exposure Draft; and
- (b) the 'AASB Specific Matters for Comment' listed below.

Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

Due Date for Comments to the AASB

Comments should be submitted to the AASB by 24 September 2010. This will enable the AASB to consider those comments in the process of formulating its own comments to the IASB. Constituents are also strongly encouraged to send their response to the IASB.

AASB Specific Matters for Comment

1. The AASB would particularly value comments on whether:
 - (a) there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:
 - (i) not-for-profit entities; and
 - (ii) public sector entities;
 - (b) overall, the proposals would result in financial statements that would be useful to users;
 - (c) the proposals are in the best interests of the Australian and New Zealand economies; and
 - (d) any of the proposed disclosures should be considered for exclusion from the reduced disclosure requirements.

Relationship to other AASB Projects

The Exposure Draft is the second stage in the development by the IASB and the US Financial Accounting Standards Board (FASB) of conceptual guidance and a new comprehensive Standard for revenue recognition. In IFRSs, it is planned that the Standard arising from the Exposure Draft will replace the existing Standards on revenue recognition, namely, IAS 11 *Construction Contracts* and IAS 18 *Revenue*.

Accordingly, the AASB expects that the IASB-FASB revenue recognition project will ultimately lead to a replacement Standard for AASB 111 *Construction Contracts* and AASB 118 *Revenue*, as well as an amendment to the AASB *Framework for the Preparation*

and Presentation of Financial Statements. Other Australian Accounting Standards might also be subject to consequential amendments. The AASB will consider the implications of the Exposure Draft proposals for GAAP/GFS harmonisation.

The IASB does not intend to review and amend IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* as part of its revenue recognition project. Similarly, the AASB does not intend to review and amend AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance* in connection with the IASB's revenue recognition project. AASB 120 only applies to Australian for-profit entities.

Australian not-for-profit entities apply AASB 1004 *Contributions* instead of AASB 120. The AASB is progressing a project with the New Zealand FRSB to develop a replacement Standard for AASB 1004 that is based on International Public Sector Accounting Standard IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. The current view of the AASB and FRSB is that the principles in that replacement Standard for AASB 1004 would have regard to, but would not need to be consistent with the principles in the replacement Standard for AASB 111 *Construction Contracts* and AASB 118 *Revenue* issued as a consequence of the IASB-FASB revenue recognition project.

June 2010

Exposure Draft ED/2010/6

Revenue from Contracts with Customers

Comments to be received by 22 October 2010



International
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Exposure Draft
Revenue from Contracts
with Customers

Comments to be received by 22 October 2010

ED/2010/6

This exposure draft *Revenue from Contracts with Customers* is published by the International Accounting Standards Board (IASB) for comment only. Comments on the exposure draft and the Basis for Conclusions should be submitted in writing so as to be received by **22 October 2010**. Respondents are asked to send their comments electronically to the IASB website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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Introduction and questions for respondents

Why are the IASB and the FASB publishing this exposure draft?

- IN1 Revenue is a crucial number to users of financial statements in assessing a company's performance and prospects. However, revenue recognition requirements in US generally accepted accounting principles (GAAP) differ from those in International Financial Reporting Standards (IFRSs), and both sets of requirements are considered to be in need of improvement. US GAAP comprises broad revenue recognition concepts and numerous requirements for particular industries or transactions that can result in different accounting for economically similar transactions. Although IFRSs provide less guidance on revenue recognition, the two main revenue recognition standards, IAS 18 *Revenue* and IAS 11 *Construction Contracts*, can be difficult to understand and apply to transactions beyond simple transactions. In addition, those standards have limited guidance on important topics such as revenue recognition for multiple-element arrangements.
- IN2 Accordingly, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) initiated a joint project to clarify the principles for recognising revenue and to develop a common revenue standard for IFRSs and US GAAP that would:
- (a) remove inconsistencies and weaknesses in existing revenue recognition 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) simplify the preparation of financial statements by reducing the number of requirements to which entities must refer.
- IN3 To meet those objectives, the IASB and the FASB have jointly developed a draft standard on revenue and, hence, are proposing amendments to IFRSs and to the *FASB Accounting Standards Codification*TM (ASC).

Who would be affected by the proposals?

- IN4 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 other IFRSs or other requirements of US GAAP.
- IN5 In IFRSs, the proposed requirements would supersede IAS 18 and IAS 11 and related Interpretations. In US GAAP, the proposed requirements would supersede most of the requirements on revenue recognition in ASC Topic 605.
- IN6 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 within the scope of IAS 16 *Property, Plant and Equipment* or IAS 40 *Investment Property* or ASC Topic 360) would be amended to be consistent with the proposed revenue recognition and measurement requirements.
- IN7 Appendix C contains additional information on proposed consequential amendments to other IFRSs.

What are the main proposals?

- IN8 The proposed requirements specify 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. In summary, the core principle would require an entity 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.
- IN9 To apply that principle, an entity would:
- (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.

REVENUE FROM CONTRACTS WITH CUSTOMERS

IN10 The proposed requirements also specify the accounting for some costs. An entity would recognise the costs of obtaining a contract as expenses when incurred. If the costs incurred in fulfilling a contract are not eligible for capitalisation in accordance with other standards (for example, IAS 2 *Inventories* or ASC Topic 330 on inventory), an entity would recognise an asset only if those costs:

- (a) relate directly to a contract (or a specific contract under negotiation);
- (b) generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and
- (c) are expected to be recovered.

Identify the contract(s) with a customer

IN11 In most cases, an entity would apply the proposed requirements to a single contract. However, the proposals specify when an entity would combine two or more contracts and account for them as a single contract or segment a single contract and account for it as two or more contracts.

Identify the separate performance obligations in the contract

IN12 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.

IN13 If an entity promises to provide more than one good or service, it would account for each promised good or service as a separate performance obligation if the good or service is distinct.

IN14 A good or service is distinct if either:

- (a) the entity, or another entity, sells an identical or similar good or service separately; or
- (b) the entity could sell the good or service separately because the good or service has a distinct function and a distinct profit margin.

Determine the transaction price

- IN15 The transaction price is the amount of consideration that an entity receives, or expects to receive, from a customer in exchange for transferring goods or services promised in the contract. In many contracts, the transaction price is readily determinable because the customer promises to pay a fixed amount of consideration and that payment is made at or near the time of the transfer of the promised goods or services.
- IN16 If the amount of consideration is variable (for instance, because of rebates, bonuses, penalties or the customer's credit risk), an entity would recognise revenue from satisfying a performance obligation if the transaction price can be reasonably estimated. The transaction price can be reasonably estimated only if both of the following conditions are met:
- (a) the entity has experience with similar types of contracts (or access to the experience of other entities if it has no experience of its own); and
 - (b) the entity's experience is relevant to the contract because the entity does not expect significant changes in circumstances.
- IN17 When determining the transaction price, an entity would consider the effects of the following:
- (a) collectibility;
 - (b) the time value of money;
 - (c) non-cash consideration; and
 - (d) consideration payable to the customer.

Allocate the transaction price to the separate performance obligations

- IN18 An entity would allocate the transaction price to all separate performance obligations in proportion to the stand-alone selling prices of the goods or services underlying each of those performance obligations at contract inception. If a stand-alone selling price is not directly observable, the entity would estimate it.
- IN19 The entity would update the transaction price over the life of the contract to reflect changes in circumstances and allocate changes in the transaction price to the separate performance obligations (see paragraph IN22).

Recognise revenue when a performance obligation is satisfied

- IN20 An entity would recognise revenue when it satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service.
- IN21 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. The proposed requirements include indicators to assist an entity in determining when a customer has obtained control of a good or service.
- IN22 When an entity satisfies a performance obligation, an entity would recognise revenue in the amount of the transaction price allocated to the satisfied performance obligation. If the transaction price changes after contract inception, the amount of the change allocated to performance obligations already satisfied at the time the transaction price changes would be recognised as revenue in the period in which the transaction price changes.
- IN23 When the promised goods or services underlying a separate performance obligation are transferred to a customer continuously, an entity would apply to that performance obligation one revenue recognition method that best depicts the transfer of goods or services to the customer. Acceptable methods include methods based on an entity's outputs or inputs and methods based on the passage of time.

How would the proposals affect IFRSs and US GAAP?

- IN24 The boards envisage that the accounting for revenue (and some costs) arising from contracts within the scope of the proposed requirements would be the same in both IFRSs and US GAAP. However, differences might exist between IFRSs and US GAAP in the profit margin reported in those contracts because of differences in other standards relating to accounting for the costs of fulfilling a contract (for example, IAS 2 or ASC Topic 330).
- IN25 For some contracts (for example, many retail transactions), the proposed requirements would have little, if any, effect on current practice. However, the proposed requirements would differ from current practice in the following ways:
- (a) *recognition of revenue only from the transfer of goods or services—contracts for the development of an asset (for example, construction,*

manufacturing and customised software) would result in continuous revenue recognition only if the customer controls the asset as it is developed.

- (b) *identification of separate performance obligations*—an entity would be required to divide a contract into separate performance obligations for goods or services that are distinct. As a result of those requirements, an entity might separate a contract into units of accounting that differ from those identified in current practice.
- (c) *licensing and rights to use*—an entity would be required to evaluate whether a licence to use the entity's intellectual property (for less than the property's economic life) is granted on an exclusive or non-exclusive basis. If a licence is granted on an exclusive basis, an entity would be required to recognise revenue over the term of the licence. That pattern of revenue recognition might differ from current practice.
- (d) *effect of credit risk*—in contrast to some existing standards and practices, the effect of a customer's credit risk (ie collectibility) would affect *how much* revenue an entity recognises rather than *whether* an entity recognises revenue.
- (e) *use of estimates*—in determining the transaction price (for example, estimating variable consideration) and allocating the transaction price on the basis of stand-alone selling prices, an entity would be required to use estimates more extensively than in applying existing standards.
- (f) *accounting for costs*—the proposed requirements specify which contract costs an entity would recognise as expenses when incurred and which costs would be capitalised because they give rise to an asset. Applying that cost guidance might change how an entity would account for some costs.
- (g) *disclosure*—the proposed requirements specify disclosures to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. An entity would be required to disclose more information about its contracts with customers than is currently required, including more disaggregated information about recognised revenue and more information about its performance obligations remaining at the end of the reporting period.

When would the proposals be effective?

- IN26 The IASB and the FASB are working on various projects, including this project, as part of their commitment under the updated Memorandum of Understanding *A Roadmap for Convergence between IFRSs and US GAAP—2006–2008*. Because the boards expect to issue several standards in 2011, they plan to invite additional comment through a separate consultation on how best to change to the new requirements.

Questions for respondents

- IN27 The boards invite individuals and organisations to comment on all matters in this exposure draft, particularly on the issues and questions below. Comments are requested from those who agree with the proposals as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposals are asked to describe their suggested alternatives, supported by specific reasoning.
- IN28 Respondents should submit one comment letter to either the FASB or the IASB. The boards will share and jointly consider all comment letters received.

Recognition of revenue (paragraphs 8–33)

Question 1: Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether:

- (a) to combine two or more contracts and account for them as a single contract;
- (b) to segment a single contract and account for it as two or more contracts; and
- (c) to account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

Question 2: The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

Question 3: Do you think that the proposed guidance in paragraphs 25–31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

Measurement of revenue (paragraphs 34–53)

Question 4: The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

Question 5: Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect *how much* revenue an entity recognises when it satisfies a performance obligation rather than *whether* the entity recognises revenue? If not, why?

Question 6: Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

Question 7: Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

Contract costs (paragraphs 57–63)

Question 8: Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38 *Intangible Assets* or ASC Topic 985 on software), an entity should recognise an asset only if those costs meet specified criteria.

Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?

Question 9: Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

Disclosure (paragraphs 69–83)

Question 10: The objective of the boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

Question 11: The boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

Question 12: Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

Effective date and transition (paragraphs 84 and 85)

Question 13: Do you agree that an entity should apply the proposed requirements retrospectively (ie as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

Application guidance (paragraphs B1–B96)

Question 14: The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

Question 15: The boards propose that an entity should distinguish between the following types of product warranties:

- (a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.
- (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

Question 16: The boards propose the following if a licence is not considered to be a sale of intellectual property:

- (a) if an entity grants a customer an exclusive licence to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the licence; and
- (b) if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer

the licence and it satisfies that obligation when the customer is able to use and benefit from the licence.

Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

Consequential amendments

Question 17: The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

Non-public entities

Question 18 [FASB only]: Should any of the proposed requirements be different for non-public entities (private companies and not-for-profit organisations)? If so, which requirement(s) and why?

Public round-table meetings

IN29 The boards plan to hold public round-table meetings after the end of the comment period. The purpose of such meetings is to listen to the views of, and obtain information from, interested parties about the proposed requirements. The boards plan to seek participants for the meetings that represent a wide variety of constituents (including users, preparers, auditors and others) to ensure that they receive broad input. Any individual or organisation wishing to take part must notify the IASB by sending an email by 1 October 2010 to Jennifer Wilson, Outreach Co-ordinator, at jwilson@iasb.org, containing a description of the issues suggested for discussion at the meetings. Any interested party must also submit its comments on the proposals in writing by 22 October 2010. Round-table meetings can accommodate a limited number of participants. Depending on the number of responses received, the boards may not be able to accommodate all requests to participate.

[Draft] International Financial Reporting Standard X *Revenue from Contracts with Customers* ([draft] IFRS X) is set out in paragraphs 1–86 and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the [draft] IFRS. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. [Draft] IFRS X should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

[Draft] International Financial Reporting Standard X ***Revenue from Contracts with Customers***

Introduction

- 1 This [draft] IFRS specifies the accounting for revenue (and some costs) arising from contracts with customers. It does not address revenue arising from other transactions or activities (for example, revenues arising from changes in the value of some mineral, biological or agricultural assets).
- 2 The core principle in this [draft] IFRS is that an entity shall recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration the entity receives, or expects to receive, in exchange for those goods or services. To apply this [draft] IFRS, an entity shall:
 - (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.
- 3 An entity shall consider the terms of the contract and all related facts and circumstances when using judgement in the application of this [draft] IFRS. An entity shall apply this [draft] IFRS consistently to contracts with similar characteristics and in similar circumstances.
- 4 [This paragraph in the FASB exposure draft is not used in the IASB exposure draft]

Objective

- 5 The objective of this [draft] IFRS is to establish the principles that an entity shall apply to report useful information to users of its financial statements about the amount, timing and uncertainty of *revenue* and cash flows arising from a *contract* with a *customer*.

Scope

- 6 This [draft] IFRS applies to all contracts with customers except:
- (a) lease contracts within the scope of IAS 17 *Leases*;
 - (b) insurance contracts within the scope of IFRS 4 *Insurance Contracts*;
 - (c) contractual rights or obligations within the scope of IFRS 9 *Financial Instruments* or IAS 39 *Financial Instruments: Recognition and Measurement*; and
 - (d) [this paragraph in the FASB exposure draft is not used in the IASB exposure draft]
 - (e) non-monetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange (for example, an exchange of oil to fulfil demand on a timely basis in a specified location).
- 7 A contract with a customer may be partially within the scope of this [draft] IFRS 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 shall first apply those separation and/or measurement requirements. If the other IFRSs do not specify how to separate and/or initially measure any parts of the contract, the entity shall apply this [draft] IFRS to separate and/or initially measure those parts of the contract.

Recognition of revenue

Identifying the contract

- 8 **An entity shall apply this [draft] IFRS to each contract identified in accordance with paragraphs 9–19.**
- 9 Contracts can be written, oral or implied by the entity's customary business practice. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities, and they may also vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining whether a contract exists.
- 10 A contract exists for the purpose of applying the revenue requirements of this [draft] IFRS only if:

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- (a) the contract has commercial substance (ie the entity's future cash flows are expected to change as a result of the contract);
 - (b) the parties to the contract have approved the contract and are committed to satisfying their respective obligations;
 - (c) the entity can identify each party's enforceable rights regarding the goods or services to be transferred; and
 - (d) the entity can identify the terms and manner of payment for those goods or services.
- 11 A contract does not exist for the purpose of applying this [draft] IFRS if either party can terminate a wholly unperformed contract without penalty. A wholly unperformed contract is a contract under which the entity has not transferred any goods or services and the customer has not paid any consideration.

Combination and segmentation of contracts (see paragraph B2)

- 12 In most cases, an entity applies this [draft] IFRS to a single contract with a customer. However, in some cases, the amount and timing of revenue might depend on whether an entity combines contracts or segments a contract.
- 13 An entity shall combine two or more contracts and account for them as a single contract if the amount of consideration for goods or services in one contract is dependent on the amount of consideration for goods or services in another contract—in other words, the prices of the contracts are interdependent. Indicators that two or more contracts have interdependent prices include the following:
- (a) the contracts are entered into at or near the same time;
 - (b) the contracts are negotiated as a package with a single commercial objective; and
 - (c) the contracts are performed either concurrently or consecutively.
- 14 The price of a contract is not interdependent with the price of another contract solely because the customer receives a discount on goods or services in the contract as a result of an existing customer relationship arising from previous contracts.

- 15 Conversely, an entity shall segment a single contract and account for it as two or more contracts if the price of some goods or services in the contract is independent of the price of other goods or services in the contract. Goods or services are priced independently of other goods or services in the same contract only if both of the following conditions are met:
- (a) the entity, or another entity, regularly sells identical or similar goods or services separately; and
 - (b) the customer does not receive a significant discount for buying some goods or services together with other goods or services in the contract.
- 16 If an entity segments a contract in accordance with paragraph 15, the entity shall allocate the total amount of consideration to each identified contract in proportion to the *stand-alone selling prices* of the goods or services in each identified contract (ie on a relative stand-alone selling price basis). An entity shall allocate subsequent changes in the amount of consideration only to the identified contract to which those changes relate (for example, changes arising because the amount of consideration is variable as described in paragraphs 35 and 36).

Contract modifications (see paragraph B3)

- 17 A contract modification is any change in the scope or price of a contract. Examples include changes in the nature or amount of the goods or services to be transferred, changes in the method or timing of performance, and changes in the previously agreed pricing in the contract. A contract modification may be initiated by either the customer or the entity.
- 18 An entity shall apply the revenue requirements of this [draft] IFRS to a contract modification only if the conditions in paragraph 10 are met.
- 19 An entity shall account for a contract modification together with the existing contract if the prices of the modification and the existing contract are interdependent (as described in paragraph 13). In that case, the entity shall recognise the cumulative effect of the contract modification in the period in which the modification occurs. Hence, the cumulative accounting after the contract modification shall be the same as it would have been if the modification had been included in the existing contract. If the prices of the contract modification and the existing contract are not interdependent, the entity shall account for the contract modification as a separate contract.

**Identifying separate performance obligations
(see paragraphs B4–B43)**

- 20 **An entity shall evaluate the terms of the contract and its customary business practice to identify all promised goods or services and determine whether to account for each promised good or service as a separate performance obligation.**
- 21 Contracts with customers oblige an entity to provide goods or services in exchange for consideration. Goods or services include the following:
- (a) goods produced by an entity for sale (for example, inventory of a manufacturer);
 - (b) goods purchased by an entity for resale (for example, merchandise of a retailer);
 - (c) arranging for another party to transfer goods or services (for example, acting as an agent of another party);
 - (d) standing ready to provide goods or services (for example, when-and-if available software products);
 - (e) constructing or developing an asset on behalf of a customer;
 - (f) granting licences, rights to use and options; and
 - (g) performing a contractually agreed task (or tasks).
- 22 If an entity promises to transfer more than one good or service, the entity shall account for each promised good or service as a separate performance obligation only if it is distinct. If a good or service is not distinct, an entity shall combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that is distinct. In some cases, that would result in an entity accounting for all the goods or services promised in the contract as a single performance obligation.
- 23 A good or service, or a bundle of goods or services, is distinct if either:
- (a) the entity, or another entity, sells an identical or similar good or service separately; or
 - (b) the entity could sell the good or service separately because the good or service meets both of the following conditions:
 - (i) it has a distinct function—a good or service has a distinct function if it has utility either on its own or together with other goods or services that the customer has acquired from

the entity or are sold separately by the entity or by another entity; and

- (ii) it has a distinct profit margin—a good or service has a distinct profit margin if it is subject to distinct risks and the entity can separately identify the resources needed to provide the good or service.

- 24 When an entity transfers promised goods or services to a customer at the same time, it is not necessary to apply the recognition and measurement requirements of this [draft] IFRS 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. For example, if an entity transfers two distinct services to a customer over the same time period, it could account for the promises to transfer those services as a single performance obligation if applying the same revenue recognition method to both services would faithfully depict the transfer of services to the customer (as described in paragraph 32).

Satisfaction of performance obligations (see paragraphs B44–B73)

- 25 **An entity shall recognise revenue when it satisfies a performance obligation identified in accordance with paragraphs 20–24 by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains *control* of that good or service.**
- 26 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. Control includes the ability to prevent other entities from directing the use of, and receiving the benefit from, a good or service.
- 27 The customer's ability to direct the use of a good or service (ie an asset) refers to the present right to use the asset for its remaining economic life or to consume the asset in the customer's activities. The customer's ability to receive the benefit from an asset refers to its present right to obtain substantially all of the potential cash flows from that asset (either an increase in cash inflows or a decrease in cash outflows). The customer can obtain cash flows from an asset directly or indirectly in many ways such as by using, consuming, selling, exchanging, pledging or holding the asset.

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- 28 If an entity retains some rights to an asset solely as protection against the customer's failure to comply with the terms of the contract (for example, when an entity retains legal title as protection against the customer's failure to pay), those rights are protective rights and do not preclude a customer from obtaining control of an asset.
- 29 When assessing whether a customer obtains control of an asset, an entity shall consider any related arrangements entered into at or near the same time as, or in contemplation of, the contract (for example, repurchase agreements).
- 30 An entity shall assess the transfer of control of goods or services for each separate performance obligation. Indicators that the customer has obtained control of a good or service include the following:
- (a) The customer has an unconditional obligation to pay—if a customer is unconditionally obliged to pay for a good or service, typically that is because the customer has obtained control of the good or service in exchange. An obligation to pay is unconditional when nothing other than the passage of time is required before the payment is due.
 - (b) The customer has legal title—legal title often indicates which party has the ability to direct the use of, and receive the benefit from, a good. Benefits of legal title include the ability to sell a good, exchange it for another asset, or use it to secure or settle debt. Hence, the transfer of legal title often coincides with the transfer of control. However, in some cases, possession of legal title is a protective right and may not coincide with the transfer of control to a customer.
 - (c) The customer has physical possession—in many cases, the customer's physical possession of a good gives the customer the ability to direct the use of that good. In some cases, however, physical possession does not coincide with control of a good. For example, in some consignment and in some sale and repurchase arrangements, an entity may have transferred physical possession but retained control of a good. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of a good that the customer controls.
 - (d) The design or function of the good or service is customer-specific—a good or service with a customer-specific design or function might be of little value to an entity because the good or service lacks an alternative use. For instance, if an entity cannot sell a customer-

specific asset to another customer, it is likely that the entity would require the customer to obtain control of the asset (and pay for any work completed to date) as it is created. A customer's ability to specify only minor changes to the design or function of a good or service or to choose from a range of standardised options specified by the entity typically would not indicate a customer-specific good or service. However, a customer's ability to specify major changes to the design or function of the good or service would indicate that a customer obtains control of the asset as it is created.

- 31 Not one of the preceding indicators determines by itself whether the customer has obtained control of the good or service. Moreover, some indicators may not be relevant to a particular contract (for example, physical possession and legal title would not be relevant to services).

Continuous transfer of goods or services

- 32 When the promised goods or services underlying a separate performance obligation are transferred to a customer continuously, 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.
- 33 Suitable methods of recognising revenue to depict the continuous transfer of goods or services to the customer include the following:
- (a) output methods that recognise revenue on the basis of units produced or delivered, contract milestones, or surveys of goods or services transferred to date relative to the total goods or services to be transferred. Output methods often result in the most faithful depiction of the transfer of goods or services. However, other methods may also provide a faithful depiction but at a lower cost.
 - (b) input methods that recognise revenue on the basis of efforts expended to date (for example, costs of resources consumed, labour hours expended and machine hours used) relative to total efforts expected to be expended. Inputs often are more directly observable than outputs. However, a significant drawback of input methods is that there may not be a direct relationship between the efforts expended and the transfer of goods or services because of deficiencies in the entity's performance or other factors. When using an input method, an entity shall exclude the effects of any inputs that do not depict the transfer of goods or services to the

customer (for example, the costs of abnormal amounts of wasted materials, labour or other resources to fulfil the contract).

- (c) methods based on the passage of time. An entity would recognise revenue on a straight-line basis over the expected duration of the contract if services are transferred evenly over time (for example, as in some licences).

Measurement of revenue

- 34 When an entity satisfies a performance obligation, it shall recognise as revenue the amount of the *transaction price* allocated to that performance obligation.**

Determining the transaction price (see paragraphs B74–B85)

- 35 An entity shall consider the terms of the contract and its customary business practice to determine the transaction price for the contract with the customer. The transaction price reflects the probability-weighted amount of consideration that an entity expects to receive from the customer in exchange for transferring goods or services.
- 36 In many contracts, the transaction price is readily determinable because the customer promises to pay a fixed amount of consideration and that payment is made at or near the time of the transfer of the promised goods or services. In other contracts, the amount of consideration is variable, and the transaction price must be estimated at each reporting period to represent faithfully the circumstances present at the reporting date and the changes in circumstances during the reporting period. The amount of consideration could vary because of discounts, rebates, refunds, credits, incentives, performance bonuses/penalties, contingencies, price concessions, the customer's credit risk or other similar items.
- 37 If an entity receives consideration from a customer and expects to refund some or all of that consideration to the customer, the entity shall recognise a refund liability. The entity shall measure that liability at the probability-weighted amount of consideration that the entity expects to refund to the customer (ie the difference between the amount of consideration received and the transaction price). The refund liability shall be updated at each reporting period for changes in circumstances.

- 38 An entity shall recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. The transaction price can be reasonably estimated only if both of the following conditions are met:
- (a) the entity has experience with similar types of contracts (or access to the experience of other entities if it has no experience of its own); and
 - (b) the entity's experience is relevant to the contract because the entity does not expect significant changes in circumstances.
- 39 Factors that reduce the relevance of an entity's experience include the following:
- (a) the consideration amount is highly susceptible to external factors (for example, volatility in the market, judgement of third parties and risk of obsolescence of the promised good or service);
 - (b) the uncertainty about the amount of consideration is not expected to be resolved for a long time;
 - (c) the entity's experience with similar types of contracts is limited; and
 - (d) the contract has a large number of possible consideration amounts.
- 40 The existence of one or more of the above factors, in the light of the significance of other factors, may not be sufficient to prevent an entity's making a reasonable estimate of the transaction price; likewise, other factors may preclude a reasonable estimate.
- 41 If the transaction price cannot be reasonably estimated, an entity shall not recognise revenue from satisfying a performance obligation. If circumstances change, the entity shall recognise revenue from satisfied performance obligations when the transaction price can be reasonably estimated. If an entity can reasonably estimate some, but not all, of the consideration amount (for example, if part of the total consideration is a fixed amount), the transaction price includes only the amount that the entity can reasonably estimate.
- 42 When determining the transaction price, an entity shall consider the effects of:
- (a) collectibility;
 - (b) the time value of money;
 - (c) non-cash consideration; and

- (d) consideration payable to the customer.

Collectibility

- 43 Collectibility refers to the customer's credit risk—the customer's ability to pay the amount of promised consideration. In determining the transaction price, an entity shall reduce the amount of promised consideration to reflect the customer's credit risk. Hence, when an entity satisfies a performance obligation, the entity shall recognise revenue at the probability-weighted amount of consideration that the entity expects to receive. Once an entity has an unconditional right to consideration (ie a receivable as described in paragraph 66), the effects of changes in the assessment of credit risk associated with that right to consideration shall be recognised as income or expense rather than as revenue.

The time value of money

- 44 In determining the transaction price, an entity shall adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicitly or implicitly).
- 45 The effect of the time value of money is not material to many contracts. However, the effect is material to some contracts because payment from the customer is due either significantly before or significantly after the transfer of goods or services to the customer. In those contracts, the entity shall reflect the time value of money in the transaction price by discounting the amount of promised consideration using the rate that would be used in a separate financing transaction between the entity and its customer. That rate shall reflect both the time value of money and credit risk (hence, an entity shall not also adjust the amount of the promised consideration in accordance with paragraph 43). The entity shall present the effect of financing separately from the revenue from goods or services.

Non-cash consideration

- 46 In some contracts, an entity receives, or expects to receive, non-cash consideration. To determine the transaction price for those contracts, an entity shall measure non-cash consideration (or promise of non-cash consideration) at fair value. If an entity cannot reasonably estimate the fair value of the non-cash consideration, it shall measure the consideration indirectly by reference to the stand-alone selling price of the goods or services transferred in exchange for the consideration.

- 47 If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate the fulfilment of the contract, an entity shall assess whether it obtains control of the contributed goods or services. If so, the entity shall account for the contributed goods or services as non-cash consideration.

Consideration payable to the customer

- 48 If an entity pays, or expects to pay, consideration to the customer (or to other parties that purchase the entity's goods or services from the customer) in the form of cash or credit, or other items that the customer can apply against amounts owed to the entity, the entity shall determine whether that amount is:
- (a) a reduction of the transaction price and, hence, of revenue (ie the customer receives a discount on the entity's goods or services);
 - (b) a payment for a distinct good or service (as described in paragraph 23) that the customer supplies to the entity, in which case the entity shall account for the purchase of the good or service in the same way it accounts for other purchases from suppliers; or
 - (c) a combination of items (a) and (b), in which case the entity shall reduce the transaction price by the excess, if any, of consideration payable to the customer over the fair value of the good or service the entity receives from the customer. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, the entity shall account for the entirety of the consideration payable to the customer as a reduction of the transaction price.
- 49 If consideration paid (or expected to be paid) to a customer is a reduction of the transaction price, an entity shall recognise the reduction of revenue when the later of the following occurs:
- (a) the entity transfers the promised goods or services to the customer; and
 - (b) the entity promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practice.

Allocating the transaction price to separate performance obligations (see paragraphs B86–B88)

- 50 An entity shall allocate the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the good or service underlying each of those performance obligations at contract inception (ie on a relative stand-alone selling price basis).
- 51 The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately. A contractually stated price or a list price for a good or service shall not be presumed to represent the stand-alone selling price of that good or service. If a stand-alone selling price is not directly observable, an entity shall estimate it.
- 52 When estimating stand-alone selling prices, an entity shall maximise the use of observable inputs and shall apply estimation methods consistently for goods or services and customers with similar characteristics. Suitable estimation methods include the following:
- (a) expected cost plus a margin approach—an entity could forecast its expected costs of satisfying a performance obligation and then add the margin that the entity would require for that good or service; and
 - (b) adjusted market assessment approach—an entity could evaluate the market in which it sells goods or services and estimate the price that customers in that market would be willing to pay for those goods or services. That approach might also include referring to prices from the entity’s competitors for similar goods or services and adjusting those prices as necessary to reflect the entity’s costs and margins.

Allocating subsequent changes in the transaction price

- 53 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 allocated to satisfied performance obligations shall be recognised as revenue, or a reduction of revenue, in the period in which the transaction price changes. An entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception.

Onerous performance obligations

- 54 **An entity shall recognise a liability and a corresponding expense if a performance obligation is onerous.**
- 55 A performance obligation is onerous if the present value of the probability-weighted costs that relate directly to satisfying that performance obligation (as described in paragraph 58) exceeds the amount of the transaction price allocated to that performance obligation. Before an entity recognises a liability for an onerous performance obligation, it shall recognise any impairment loss that has occurred on assets related to the contract (for example, inventory or an asset recognised in accordance with paragraph 57).
- 56 At each subsequent reporting date, an entity shall update the measurement of the liability for an onerous performance obligation using current estimates. An entity shall recognise changes in the measurement of that liability as an expense or as a reduction of an expense. When an entity satisfies the liability for an onerous performance obligation, it shall recognise the corresponding income as a reduction of an expense.

Contract costs (see paragraphs B89 and B90)

- 57 **If the costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with another IFRS (for example, IAS 2 Inventories, IAS 16 Property, Plant and Equipment or IAS 38 Intangible Assets), an entity shall recognise an asset only if those costs:**
- (a) **relate directly to a contract (or a specific contract under negotiation) as described in paragraph 58;**
 - (b) **generate or enhance resources of the entity that will be used in satisfying performance obligations in the future (ie the costs relate to future performance); and**
 - (c) **are expected to be recovered.**
- 58 Costs that relate directly to a contract are:
- (a) direct labour (for example, salaries and wages of employees who provide services direct to the customer);
 - (b) direct materials (for example, supplies used in providing services to the customer);

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- (c) allocations of costs that relate directly to the contract or contract activities (for example, costs of contract management and depreciation of tools and equipment used in fulfilling the contract);
 - (d) costs that are explicitly chargeable to the customer under the contract; and
 - (e) other costs that were incurred only because the entity entered into the contract (for example, subcontractor costs).
- 59 An entity shall recognise the following costs as expenses when incurred:
- (a) costs of obtaining a contract (for example, the costs of selling, marketing, advertising, bid and proposal, and negotiations);
 - (b) costs that relate to satisfied performance obligations in the contract (ie the costs that relate to past performance); and
 - (c) costs of abnormal amounts of wasted materials, labour or other resources used to fulfil the contract.
- 60 If an entity cannot distinguish the costs that relate to future performance from the costs that relate to past performance, the entity shall recognise those costs as expenses when incurred.
- 61 An asset recognised in accordance with paragraph 57 shall be amortised on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates.**
- 62 An entity shall classify an asset recognised in accordance with paragraph 57 on the basis of the nature or function of the costs that gave rise to the asset (for example, intangible or work in progress).
- 63 An entity shall recognise an impairment loss to the extent that the carrying amount of an asset recognised in accordance with paragraph 57 exceeds the amount of the transaction price allocated to the remaining performance obligations less the costs that relate directly to satisfying those performance obligations (as described in paragraph 58).**

Presentation (see paragraph B91)

- 64 When either party to a contract has performed, the entity shall present the contract in the statement of financial position as either a *contract asset* or a *contract liability* depending on the relationship between the entity's performance and the customer's performance.**

- 65 If an entity performs by transferring goods or services to a customer before the customer performs by paying consideration, the entity shall present the contract as a contract asset. Conversely, if a customer performs before an entity performs, the entity shall present the contract as a contract liability.
- 66 An entity shall present an unconditional right to consideration as a receivable (not as a contract asset) and shall account for that receivable in accordance with IFRS 9. A right to consideration is unconditional when nothing other than the passage of time is required before payment of that consideration is due.
- 67 An entity shall present any asset recognised in accordance with paragraph 57 separately from the contract asset or contract liability.
- 68 An entity shall present any liability recognised for an onerous performance obligation separately from any contract asset or contract liability.

Disclosure (see paragraphs B92–B96)

- 69 **To help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, an entity shall disclose qualitative and quantitative information about:**
- (a) **its contracts with customers (paragraphs 73–80); and**
 - (b) **the significant judgements, and changes in judgements, made in applying the [draft] IFRS to those contracts (paragraphs 81–83).**
- 70 An entity shall consider the level of detail necessary to satisfy the disclosure requirements and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.
- 71 If the disclosures provided in accordance with this [draft] IFRS and other IFRSs do not meet the objective in paragraph 69, an entity shall disclose whatever additional information is necessary to meet that objective.

- 72 Other IFRSs (for example, IFRS 8 *Operating Segments*) require an entity to present and disclose information related to revenue. The entity need not disclose information in accordance with this [draft] IFRS if it has provided the information in accordance with another IFRS. However, an entity shall present and disclose the additional information in accordance with this [draft] IFRS in a way that shows how it relates to information required by that other IFRS.

Contracts with customers

- 73 An entity shall disclose information about its contracts with customers to help users understand the amount, timing and uncertainty of revenue and cash flows from those contracts, including:
- (a) a disaggregation of revenue for the period (paragraph 74);
 - (b) a reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities (paragraphs 75 and 76); and
 - (c) information about the entity's performance obligations (paragraphs 77 and 78), including additional information about its onerous performance obligations (paragraphs 79 and 80).

Disaggregation of revenue

- 74 An entity shall disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Examples of categories that might be appropriate include:
- (a) type of good or service (for example, major product lines);
 - (b) geography (for example, country or region);
 - (c) market or type of customer (for example, government versus non-government customers); or
 - (d) type of contract (for example, a fixed-price versus a time-and-materials contract).

Reconciliation of contract balances

- 75 An entity shall provide a reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities. The reconciliation shall, at a minimum, show each of the following, if applicable:

- (a) the amount(s) recognised in the statement of comprehensive income arising from:
 - (i) revenue from performance obligations satisfied during the reporting period;
 - (ii) revenue from allocating changes in the transaction price to performance obligations satisfied in previous reporting periods;
 - (iii) interest income and expense; and
 - (iv) the effect of changes in foreign exchange rates;
- (b) cash received;
- (c) amounts transferred to receivables;
- (d) non-cash consideration received; and
- (e) contracts acquired in business combinations and contracts disposed.

76 An entity shall reconcile the opening and closing aggregate balance of contract assets and contract liabilities to the amounts presented in the statement of financial position.

Performance obligations

- 77 An entity shall disclose information about its performance obligations in contracts with customers, including a description of:
- (a) the goods or services the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (ie if the entity is acting as an agent);
 - (b) when the entity typically satisfies its performance obligations (for example, upon shipment, upon delivery, as services are rendered or upon completion of service);
 - (c) the significant payment terms (for example, whether the consideration amount is variable and whether the contract has a material financing component);
 - (d) obligations for returns, refunds and other similar obligations; and
 - (e) types of warranties and related obligations.

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- 78 For contracts with an original expected duration of more than one year, an entity shall disclose the amount of the transaction price allocated to the performance obligations remaining at the end of the reporting period that are expected to be satisfied in each of the following periods:
- (a) not later than one year;
 - (b) later than one year but not later than two years;
 - (c) later than two years but not later than three years; and
 - (d) later than three years.

Onerous performance obligations

- 79 An entity shall disclose the amount of any liability recognised for onerous performance obligations together with a discussion of:
- (a) the nature and amount of the performance obligations for which the liability has been recognised;
 - (b) why those performance obligations have become onerous; and
 - (c) when the entity expects to satisfy the liability.
- 80 An entity shall provide a reconciliation from the opening to the closing balance of the liability recognised for onerous performance obligations. The reconciliation shall show the amounts recognised in the statement of comprehensive income attributable to each of the following, if applicable:
- (a) performance obligations that became onerous during the period;
 - (b) performance obligations that ceased to be onerous during the period;
 - (c) amount of the liability that was satisfied during the period;
 - (d) the time value of money; and
 - (e) changes in the measurement of the liability that occurred during the reporting period.

Significant judgements in the application of the [draft] IFRS

- 81 An entity shall disclose the judgements, and changes in judgements, made in applying this [draft] IFRS that significantly affect the determination of the amount and timing of revenue from contracts with customers. That disclosure shall explain the judgements used in:
- (a) determining the timing of satisfaction of performance obligations (paragraph 82); and
 - (b) determining the transaction price and allocating it to performance obligations (paragraph 83).

Determining the timing of satisfaction of performance obligations

- 82 For performance obligations satisfied continuously, an entity shall disclose:
- (a) the methods (for example, output methods, input methods and methods based on the passage of time) used to recognise revenue; and
 - (b) an explanation of why such methods are a faithful depiction of the transfer of goods or services.

Determining the transaction price and allocating it to performance obligations

- 83 An entity shall disclose information about the methods, inputs and assumptions used:
- (a) to determine the transaction price in accordance with paragraphs 35–49;
 - (b) to estimate stand-alone selling prices of promised goods or services;
 - (c) to measure obligations for returns, refunds and other similar obligations;
 - (d) to measure the amount of any liability recognised for onerous performance obligations (including information about the discount rate).

Effective date and transition

- 84 An entity shall apply this [draft] IFRS for annual periods beginning on or after [date to be inserted after exposure].
- 85 An entity shall apply this [draft] IFRS retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Withdrawal of other IFRSs

- 86 This [draft] IFRS supersedes the following IFRSs:
- (a) IAS 11 *Construction Contracts*;
 - (b) IAS 18 *Revenue*;
 - (c) IFRIC 13 *Customer Loyalty Programmes*;
 - (d) IFRIC 15 *Agreements for the Construction of Real Estate*;
 - (e) IFRIC 18 *Transfers of Assets from Customers*; and
 - (f) SIC-31 *Revenue—Barter Transactions Involving Advertising Services*.

Appendix A Defined terms

This appendix is an integral part of the [draft] IFRS.

contract	An agreement between two or more parties that creates enforceable rights and obligations.
contract asset	An entity's right to consideration from a customer in exchange for goods or services transferred to the customer.
contract liability	An entity's obligation to transfer goods or services to a customer for which the entity has received consideration from the customer.
control [of a good or service]	An entity's ability to direct the use of, and receive the benefit from, a good or service.
customer	A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities.
income	Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.
performance obligation	An enforceable promise (whether explicit or implicit) in a contract with a customer to transfer a good or service to the customer.
revenue	Income arising in the course of an entity's ordinary activities.
stand-alone selling price [of a good or service]	The price at which the entity would sell a good or service separately to the customer .
transaction price [for a contract with a customer]	The amount of consideration that an entity receives, or expects to receive, from a customer in exchange for transferring goods or services, excluding amounts collected on behalf of third parties (for example, taxes).

Appendix B

Application guidance

This appendix is an integral part of the [draft] IFRS.

- B1 The application guidance gives guidance on the following issues* :
- (a) segmentation of a contract (paragraph B2);
 - (b) contract modifications (paragraph B3);
 - (c) identifying performance obligations (paragraphs B4–B39);
 - (d) determining whether a good or service is distinct (paragraphs B40–B43);
 - (e) satisfaction of performance obligations (paragraphs B44–B73);
 - (f) determining the transaction price (paragraphs B74–B85);
 - (g) allocating the transaction price to separate performance obligations (paragraphs B86–B88);
 - (h) contract costs (paragraphs B89 and B90);
 - (i) presentation (paragraph B91); and
 - (j) disclosure (paragraphs B92–B96).

* In the FASB exposure draft, the paragraphs in this appendix are numbered IG1, IG2 etc.

Segmentation of a contract (paragraphs 15 and 16)

- B2 Paragraph 15 requires an entity to segment a single contract and account for it as two or more contracts if the price of some goods or services in the contract is independent of the price of other goods or services in the contract. The following example illustrates a single contract that would be segmented and accounted for as two contracts.

Example 1—Contract segmentation

An entity enters into a contract with a customer to sell Products A, B and C for CU36.* The entity regularly sells Products A, B and C separately for CU9, CU11 and CU20, respectively. It also regularly sells Products A and B together for CU16.

The entity segments the contract into two contracts: a contract to provide Products A and B, and a contract to provide Product C. The stand-alone selling price of Products A and B together (CU16) is independent of the stand-alone selling price of Product C. That is because the entity regularly sells Products A and B together at CU16 and Product C at CU20, and the customer does not receive a discount for buying Products A and B together with Product C (the total price for all of the products in the contract [CU36] equals the sum of the stand-alone selling prices for Products A and B together [CU16] and Product C [CU20]).

The effect of segmenting the contract into two contracts is that the CU4 discount for purchasing Products A and B together is allocated only to Products A and B.

* In this exposure draft monetary amounts are denominated in 'currency units (CU)'.

Contract modifications (paragraphs 17–19)

- B3 Paragraph 19 requires an entity to account for a contract modification together with the existing contract if the prices of the modification and the existing contract are interdependent. The following example illustrates how an entity would apply that principle.

Example 2—Contract modifications*Scenario 1—services that do not have interdependent prices*

An entity enters into a three-year services contract. The payment terms are CU100,000 payable annually in advance. The stand-alone selling price of the services at contract inception is CU100,000 per year. At the beginning of the third year (after the customer had paid the CU100,000 for that year), the entity agrees to reduce the price for the third year of services to CU80,000. In addition, the customer agrees to pay an additional CU220,000 for an extension of the contract for three years. The stand-alone selling price of the services at the beginning of the third year is CU80,000 per year.

To account for the contract modification, the entity must evaluate whether the price of the services provided before the contract modification and the price of the services provided after the contract modification are interdependent. The services provided during the first two years are priced at the stand-alone selling price of CU100,000 per year. Moreover, the services provided during the subsequent four years are priced at the stand-alone selling price of CU80,000 per year. Hence, the entity concludes that the price of the contract modification and the price of the original contract are not interdependent. Although the services are provided continuously, the price of the services in the first two years and the price of the subsequent services are negotiated at different times and in different market conditions (as evidenced by the significant change in the stand-alone selling price of the service).

Consequently, the entity accounts for the contract modification separately from the original contract. CU20,000 of the CU100,000 payment received at the beginning of the third year (before the modification) is a prepayment of services to be provided in the future years. Therefore, the entity recognises revenue of CU100,000 per year for the two years of services provided under the original contract and CU80,000 per year for services provided during the subsequent four years of services under the new contract.

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Example 2—Contract modifications

Scenario 2—services that have interdependent prices

The facts are the same as Scenario 1 except that at the beginning of the third year the customer agrees to pay an additional CU180,000 for an extension of the contract for three years.

The services provided during the first two years are priced at their stand-alone selling price of CU100,000 per year. However, the services provided during the subsequent four years are priced at a CU40,000 discount $[(CU80,000 \text{ stand-alone selling price per year} \times 4 \text{ years}) - (CU100,000 \text{ prepayment} + CU180,000 \text{ remaining payment})]$ and, therefore, their price is dependent on the price of the services in the original contract. Hence, the entity concludes that the price of the contract modification and the price of the original contract are interdependent.

Consequently, the entity accounts for the contract modification together with the original contract. At the date of modification, the entity recognises the cumulative effect of the contract modification as a reduction to revenue in the amount of CU40,000 $[(CU480,000 \text{ total consideration} \div 6 \text{ years of total services} \times 2 \text{ years' services provided}) - CU200,000 \text{ revenue recognised to date}]$. The entity recognises revenue of CU100,000 per year for the first two years, CU40,000 in the third year, and CU80,000 per year in the fourth, fifth and sixth years.

**Identifying performance obligations
(paragraphs 20–24)**

- B4 Paragraph 20 requires an entity to evaluate the terms of the contract and its customary business practice to identify all promised goods or services and determine whether to account for each promised good or service as a separate performance obligation. An entity shall consider the following guidance when applying that requirement:
- (a) sale of a product with a right of return (paragraphs B5–B12);
 - (b) product warranties and product liabilities (paragraphs B13–B19);
 - (c) principal versus agent considerations (paragraphs B20–B23);
 - (d) customer options for additional goods or services (paragraphs B24–B26);
 - (e) non-refundable upfront fees (paragraphs B27–B30); and
 - (f) licensing and rights to use (paragraphs B31–B39).

Sale of a product with a right of return

- B5 In some contracts, an entity transfers a product to a customer and also grants the customer (either contractually or by customary business practice) the right to return the product to the entity. The likelihood of a return and the duration of the return period vary significantly across industries. For example, the perishable food industry typically has a lower rate of return and a shorter return period than the publishing industry.
- B6 Reasons for a product's return include customer dissatisfaction with the product or the customer's failure to sell the product (if the customer is in the business of reselling products purchased from the entity). Contracts in which a customer may return a defective product shall be evaluated in accordance with the guidance on warranties in paragraphs B13–B19.
- B7 A customer returning a product may receive any combination of the following:
- (a) a full or partial refund of any consideration paid;
 - (b) a credit that can be applied to amounts owed or to be owed for other goods or services; or
 - (c) another product in exchange.
- B8 Exchanges by customers of one product for another of the same type, quality, condition and price (for example, one colour or size for another) are not considered returns for the purposes of applying this [draft] IFRS.
- B9 An entity's promise to stand ready to accept a returned product during the return period shall not be accounted for as a separate performance obligation in addition to the obligation to provide a refund. Instead, an entity shall recognise both of the following:
- (a) revenue for the transferred goods that are not expected to be returned; and
 - (b) a refund liability (in accordance with paragraph 37).
- B10 If an entity cannot reasonably estimate the probability of a refund to the customer in accordance with paragraphs 38–40, the entity shall not recognise revenue when it transfers the product but shall recognise any consideration received as a refund liability. In such cases, the entity shall recognise revenue when it can reasonably estimate the probability of a refund (which may be only when the return period expires).

- B11 In accordance with paragraph 37, an entity shall update the measurement of the refund liability at the end of each reporting period for changes in expectations about the amount of refunds and make a corresponding adjustment to the amount allocated to the satisfied performance obligations.
- B12 An entity shall recognise an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability. The asset shall initially be measured by reference to the former carrying amount of the inventory less any expected costs to recover those products. Subsequently, an entity shall update the measurement of the asset to correspond with changes in the measurement of the refund liability.

Example 3—Right of return

An entity sells 100 products for CU100 each. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The cost of each product is CU60. The entity estimates a 25 per cent probability that one product will be returned, a 50 per cent probability that three products will be returned, and a 25 per cent probability that five products will be returned. Therefore, the entity expects that three products will be returned ($[1 \times 25\%] + [3 \times 50\%] + [5 \times 25\%]$).

The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

Upon transfer of control of the products, the entity would not recognise revenue for the three products it expects to be returned. Consequently, the entity would recognise:

- (a) revenue of CU9,700 ($CU100 \times 97$ products expected not to be returned);
- (b) a refund liability for CU300 ($CU100 \times 3$ products expected to be returned); and
- (c) an asset of CU180 ($CU60 \times 3$ products) for its right to recover products from customers on settling the refund liability. Hence, the amount recognised in cost of sales for 97 products is CU5,820 ($CU60 \times 97$).

Product warranties and product liabilities

- B13 It is common for an entity to provide (whether explicitly in the contract or implicitly by customary business practice) a product warranty with the sale of a product. In some contracts, the product warranty may be included in the selling price of the product. In other contracts, the warranty may be priced separately as an optional extra or may be provided by a party other than the seller of the product.
- B14 An entity shall assess the objective of the product warranty. If its objective is to provide a customer with coverage for latent defects in the product (ie defects that exist when the product is transferred to the customer but are not yet apparent), that warranty does not give rise to a performance obligation in addition to the performance obligation to transfer the product. Instead, the warranty requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract. Therefore, at the reporting date the entity shall determine the likelihood and extent of defective products that it has sold to customers and, hence, the amount of unsatisfied performance obligations to transfer those products.
- B15 Consequently, if the entity would be required to replace defective products, it does not recognise any revenue for those defective products when it transfers them to customers. If the entity would be required to repair defective products, it does not recognise revenue for the portion of the transaction price attributed to the products' components expected to be replaced in the repair process.

- B16 An entity recognises revenue only for products (or components of products) that are transferred to customers in the condition promised to customers. Otherwise, the entity would not have satisfied its performance obligations.

Example 4—Product warranty that is not a performance obligation

On 31 December, an entity sells 1,000 products for CU1,000 each. The cost of each product is CU600. The entity is required by law to warrant its products against defects existing at the time of sale. For any defective product, the entity promises to replace the product during the first 90 days without additional charge. The entity's experience suggests that 1 per cent of products sold contain defects at the time of sale and will be replaced. The entity refurbishes any defective products recovered from customers and sells them at a profit.

At 31 December, the entity would estimate that it has provided 10 ($1,000 \times 1\%$) defective products that need to be replaced. Hence, for those products it recognises remaining performance obligations of CU10,000 ($10 \text{ products} \times \text{CU}1,000$). It recognises revenue for those products only when the customers obtain control of products without defects.

Because the entity has not satisfied all of its performance obligations at 31 December with respect to the products, the entity also would recognise an asset measured at CU6,000 ($10 \text{ products} \times \text{CU}600 \text{ per product}$). That asset represents the inventory that the entity has not yet transferred to the customer and is measured in accordance with IAS 2 *Inventories*.

In this example, the entity can recognise that asset at CU6,000 because it can sell the refurbished products at a profit. However, if the defective products had little or no value (for instance, if they would be scrapped), the asset would be impaired.

At 31 January, no products have been replaced, but conditions change so that the entity estimates that 12 products will need to be replaced. Hence, the entity recognises remaining performance obligations of CU12,000 ($12 \text{ products} \times \text{CU}1,000$). The CU2,000 ($\text{CU}12,000 - \text{CU}10,000$) increase is recognised as a reduction of revenue. The entity also would increase the measurement of the asset to CU7,200 ($12 \text{ products} \times \text{CU}600 \text{ per product}$) and recognise a corresponding adjustment to cost of sales.

REVENUE FROM CONTRACTS WITH CUSTOMERS

- B17 If the objective of a warranty is to provide a customer with coverage for faults that arise after the product is transferred to the customer, that warranty gives rise to a performance obligation for warranty services in addition to the performance obligation to transfer the promised product. Therefore, an entity shall allocate the transaction price (on a relative stand-alone selling price basis) between the promised product and the promised warranty service.
- B18 In assessing whether the objective of the product warranty is to provide a customer with coverage for latent defects in the product or to provide a customer with coverage for faults that arise after the product is transferred to the customer, an entity considers factors such as:
- (a) whether the warranty is required by law—if the entity is required by law to provide a warranty, that indicates that the warranty is not a performance obligation, because such requirements typically exist to protect customers from the risk of purchasing defective products.
 - (b) whether the product could have been sold without the warranty—if the product could not be sold without a warranty, that indicates the warranty is not a performance obligation. Conversely, if a warranty is sold as an optional extra, it is a separate performance obligation in accordance with paragraph 23(a).
 - (c) the length of the warranty coverage period—the longer the coverage period, the more likely that the warranty (or part of the warranty) is a performance obligation because it is more likely to provide coverage for faults arising after the product is transferred to the customer.
- B19 A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. For example, a manufacturer might sell products in a jurisdiction in which the law holds the manufacturer liable for any damages (for example, to personal property) that might be caused by a consumer using a product for its intended purpose. Similarly, an entity's promise to indemnify the customer for liabilities and damages arising from claims of patent, copyright, trademark or other infringement by the entity's products does not give rise to a performance obligation. The entity shall account for such obligations in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Principal versus agent considerations

- B20 In some contracts, an entity's customer might receive goods or services from a party other than the entity (for example, a service provider might procure and service equipment that is manufactured by another party). When other parties are involved in providing goods or services to an entity's customer, the entity must determine whether its performance obligation is to provide the goods or services itself (ie the entity is a principal), or to arrange for another party to provide those goods or services (ie the entity is an agent). That determination affects whether the entity recognises revenue in the amount of consideration received in exchange for those goods or services (if a principal) or in the amount of any fee or commission received in exchange for arranging for the other party to provide their goods or services (if an agent). An entity's fee or commission might be the net amount of consideration that the entity retains after paying other parties for providing their goods or services to the customer.
- B21 If an entity obtains control of the goods or services of another party before it transfers those goods or services to the customer, the entity's performance obligation is to provide the goods or services itself. Hence, the entity is acting as a principal and shall recognise revenue in the gross amount receivable from the customer.
- B22 Indicators that the entity's performance obligation is to arrange for the provision of goods or services by another party (ie that the entity is an agent and shall recognise revenue net) include the following:
- (a) the other party is primarily responsible for fulfilment of the contract;
 - (b) the entity does not have inventory risk before or after the customer order, during shipping or on return;
 - (c) the entity does not have latitude in establishing prices for the other party's goods or services and, hence, the benefit that the entity can receive from those goods or services is constrained;
 - (d) the entity's consideration is in the form of a commission; and
 - (e) the entity does not have customer credit risk for the amount receivable in exchange for the other party's goods or services.

REVENUE FROM CONTRACTS WITH CUSTOMERS

- B23 If an entity transfers a performance obligation to another party so that the entity is no longer obliged to provide the underlying good or service to the customer (ie the entity is no longer acting as the principal), the entity shall not recognise revenue for that performance obligation. Instead, the entity shall evaluate whether to recognise revenue for satisfying a performance obligation to obtain a customer for the other party (ie whether the entity is acting as an agent).

Customer options for additional goods or services

- B24 In many contracts, an entity grants a customer the option to acquire additional goods or services free of charge or at a discount. Those options come in many forms, including sales incentives, customer award credits (or points), contract renewal options or other discounts on future goods or services.
- B25 If an entity grants a customer the option to acquire additional goods or services, that promise gives rise to a separate performance obligation in the contract only if the option provides a material right to the customer that the customer would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires.

Example 5—Sale of a product and a future discount

An entity enters into a contract for the sale of Product A for CU100. As part of the contract, the entity gives the customer a 40 per cent discount voucher for any future purchases in the next 30 days up to CU100. The entity intends to offer a 10 per cent discount on all sales during the next 30 days as part of a seasonal promotion.

Because the discount voucher provides a material right to the customer that the customer would not receive without entering into that contract, the entity concludes that the discount voucher is a separate performance obligation in the contract for the sale of Product A. (Example 25 illustrates how much of the transaction price of CU100 would be allocated to the discount voucher.)

- B26 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 goods or services, that option does not provide the customer a material right even if the option can be exercised only because of entering into a previous contract. The entity has merely made a marketing offer.

Example 6—Telecommunication services

A telecommunications entity enters into a contract with a customer to provide up to 600 call minutes and 100 text messages each month for a fixed monthly fee. The contract specifies the price for any additional call minutes or texts that the customer may opt to purchase in any month.

The entity determines that the customer's fixed monthly payments do not include a prepayment for future services because the prices of the additional call minutes and texts are within the range of prices typically charged for those services.

Consequently, even though in this example the customer can exercise the option for any additional call minutes and text messages only because it entered into a contract, the option does not grant the customer a material right and, therefore, is not a performance obligation in the contract. Hence, the entity would recognise revenue for additional call minutes and texts only if and when the customer receives those additional services.

Non-refundable upfront fees

- B27 In some contracts, an entity charges a customer a non-refundable upfront fee at or near contract inception. Examples include joining fees in health club membership contracts, activation fees in telecommunication contracts, set-up fees in outsourcing contracts and initial fees in supply contracts.
- B28 To identify performance obligations in such contracts, an entity shall assess whether the 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. Rather, the upfront fee is an advance payment for future goods or services and, hence, would be recognised as revenue when those future goods or

services are provided. That revenue recognition period would extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right as discussed in paragraphs B24–B26.

Example 7—Non-refundable upfront fees

Scenario 1—health club membership

A health club entity enters into a contract with a customer for one year of access to any of its health clubs. The entity charges the customer a non-refundable joining fee in part as compensation for the initial activities of registering the customer. The customer can renew the contract each year without paying the joining fee.

The entity's activity of registering the customer does not transfer any service to the customer and, hence, is not a performance obligation. The customer's right to access the entity's health clubs over a specified period is a right that the customer has as a result of entering into the contract. The promised service under the contract (access to a chain of health clubs) can be provided to the customer only over time. Therefore, the joining fee is included in the transaction price allocated to the performance obligation to provide access to the health clubs and to the option to renew. Consequently, the non-refundable joining fee is recognised as revenue during the period that the entity expects to provide services to the customer.

Scenario 2—payroll processing

A payroll processing entity charges a non-refundable set-up fee at contract inception in addition to the periodic fees for the ongoing payroll processing services. The set-up fee compensates the entity for its activities of establishing the necessary records in its systems in order to be able to provide the payroll processing services. The customer can renew the contract each year without paying the set-up fee.

The entity's activities in establishing the records in its systems do not transfer any service to the customer and, hence, are not a performance obligation. The promised service under the contract is the payroll processing. Accordingly, the set-up fee is included in the transaction price allocated to the performance obligation to provide payroll processing and to the option to renew. Consequently, the non-refundable set-up fee is recognised as revenue during the period that the entity expects to provide services to the customer.

- B29 If the non-refundable upfront fee relates to a performance obligation, the entity shall evaluate whether to account for that performance obligation separately in accordance with paragraphs 20–24.
- B30 An entity may charge a non-refundable fee in part as compensation for costs incurred in setting up a contract. If those set-up activities do not satisfy a separate performance obligation, the entity shall exclude those costs from any method of revenue recognition that uses the basis of costs of resources consumed to date relative to the costs of total resources expected to be consumed (in accordance with paragraph 33(b)). That is because the costs of set-up activities do not depict the transfer of services to the customer. The entity shall evaluate whether costs incurred in setting up a contract have resulted in an asset in accordance with paragraph 57.

Licensing and rights to use

- B31 Licensing refers to an entity's granting a customer the right to use, but not own, intellectual property of the entity. Intellectual property includes all of the following:
- (a) software and technology;
 - (b) motion pictures, music and other forms of media and entertainment;
 - (c) franchises;
 - (d) patents, trademarks and copyrights; and
 - (e) other intangible assets.
- B32 IAS 17 *Leases* provides guidance on rights to use specified types of assets.
- B33 If a customer obtains control of substantially all the rights associated with the entity's intellectual property, the contract shall be considered to be a sale rather than licensing of the intellectual property. That would be the case, for instance, if an entity grants a customer the exclusive right to use its intellectual property for substantially all of the property's economic life.
- B34 If a customer does not obtain control of substantially all the rights associated with the entity's intellectual property and the entity has promised to grant exclusive rights to the customer, the entity has a performance obligation that it satisfies continuously during the period in which it permits the customer to use its intellectual property.

REVENUE FROM CONTRACTS WITH CUSTOMERS

- B35 If an entity grants rights that are not exclusive, the promised rights give rise to a single performance obligation. The entity satisfies that performance obligation when the customer is able to use and benefit from the rights, which is no sooner than the beginning of the licence period.
- B36 Rights to use are not exclusive if an entity can grant similar rights to other customers under substantially the same terms. For example, with many software products, entities grant similar rights to many customers under substantially the same terms.
- B37 An entity might grant rights to more than one customer to use the same intellectual property. However, the rights of one customer might substantially differ from the rights granted to another customer. Hence, those rights would be exclusive. An entity might grant exclusive rights on the basis of the following:
- (a) time—for example, a motion picture studio granting one customer the exclusive right to air a television series during one time period and granting another customer the exclusive right to air the same series during another time period;
 - (b) geography—for example, a franchisor granting one customer the exclusive right to a franchise in a particular region and granting another customer the exclusive right to the franchise in a different region;
 - (c) distribution channel or medium—for example, a record label granting one customer the exclusive right to distribute a soundtrack on compact disc and granting another customer the exclusive right to distribute the soundtrack via the Internet.
- B38 If an entity has a patent to intellectual property that it licenses to customers, the entity may represent and guarantee to its customers that it has a valid patent, and it will defend and maintain that patent. That promise to maintain and defend patent rights is not a performance obligation because it does not transfer a good or service to the customer. Defending a patent protects the intellectual property to which the entity has represented itself as having enforceable rights.

- B39 The following example illustrates how an entity would identify performance obligations when the entity grants a customer the right to its intellectual property.

Example 8—Franchise rights
<p>An entity enters into a contract with a customer and promises an exclusive right to open a store anywhere in a specified region. The store will bear the entity's trade name, and the customer has the right to sell the entity's products for five years. The customer promises to pay an upfront fixed fee and ongoing royalty payments of 1 per cent of the customer's quarterly sales. The customer is obliged to purchase products from the entity at their current stand-alone selling prices at the time of purchase. The entity will also provide the customer with employee training and the equipment necessary to be a distributor of the entity's products. Similar training services and equipment are sold separately.</p> <p>To identify the performance obligations, the entity must determine whether the promised rights, training services and equipment are distinct.</p> <p>The exclusive rights to the trade name, market area and proprietary know-how for five years are not distinct because individually they do not have a distinct function. However, on a combined basis, those rights have a distinct function because they provide utility together with other services that are sold separately. Hence, those rights give rise to a separate performance obligation. Because those rights are exclusive to a specified region, the entity satisfies the performance obligation to grant those rights continuously during the five-year contract.</p> <p>The training services and equipment are distinct because similar services and equipment are sold separately. The entity satisfies those performance obligations when it transfers the services and equipment to the customer.</p> <p>The entity's promise to stand ready to provide products to the customer in the future would not be accounted for as a separate performance obligation in the contract because it does not provide the customer with a material right (as described in paragraphs B24–B26).</p> <p>In accordance with the guidance in paragraphs 38–40, the entity concludes that it cannot reasonably estimate the future royalty payments because the franchise has not yet operated in that specific region and the entity does not have experience with that type of franchise agreement. Hence, the entity allocates the fixed fee to the performance obligations for the rights, the training services and the equipment on a relative stand-alone selling price basis.</p>

Determining whether a good or service is distinct (paragraph 23)

- B40 Paragraph 23 requires an entity to identify separate performance obligations by determining whether a good or service is distinct. If a good or service is not distinct, an entity shall combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that is distinct.
- B41 The following example illustrates a good and a service that are distinct.

Example 9—Specialised equipment with installation

An entity enters into a contract to sell and install specialised equipment that it has manufactured. The installation could be performed by other entities in the industry.

The equipment is distinct because, although the entity does not sell the equipment separately, the entity could sell it separately.

The equipment has a distinct function because, although the equipment does not have utility on its own without the installation, it has utility together with installation services that are sold separately. Moreover, the profit margin on the equipment is distinct because it is subject to distinct risks and the entity can separately identify the resources required to provide the equipment.

The installation services are distinct because similar services are sold by other entities separately.

Therefore, the entity would identify separate performance obligations for the equipment and for the installation. However, in accordance with paragraph 24 the entity would not need to account for them separately if the customer obtains control of the equipment only after it has been installed.

B42 The following example illustrates a licence that is not distinct.

Example 10—Technology licence with research and development services

A biotechnology entity enters into a contract with a customer and promises:

- (a) to grant to the customer exclusive rights to use the entity's Technology A for the life of its patent. The licence gives the customer the exclusive right to market, distribute and manufacture Drug B as developed using Technology A.
- (b) to provide research and development services to the customer. The entity agrees to assign four full-time equivalent employees to the research and development services. The objective is to receive regulatory approval to market and distribute Drug B using Technology A.

The customer must use the entity to perform the research and development services necessary to develop Drug B using Technology A because the know-how and expertise related to Technology A are proprietary to the entity and not available from other entities.

In this example, the licence is not distinct because it neither is sold separately (ie without the research and development services) nor could it be because it does not have a distinct function. The licence does not provide utility on its own or together with other goods or services that the customer has received from the entity or that are available from other entities. (If comparable services were sold separately by other entities, the licence would have a distinct function.)

Therefore, the entity would combine the licence with the research and development services and account for them as a single performance obligation.

- B43 The following example illustrates how an entity would identify separate performance obligations on the basis of whether each good or service is distinct and when the promised goods or services are transferred.

Example 11—Construction contract

An entity enters into a contract to construct a facility for a customer. The construction project requires engineering (design), procurement and construction activities. The design of the facility is specific to the customer's requirements, and the customer is involved in specifying major structural and functional elements of the facility. The entity procures materials and equipment as they are needed during construction. The customer obtains control of those materials and equipment as they are installed. The construction of the facility is expected to take three years. The entity also guarantees that the facility will operate in accordance with agreed-upon specifications for two years from the date of completion of construction. Other entities could provide similar services.

The design services are distinct because similar services are sold separately by the entity and by its competitors.

In this example, procurement of the materials and equipment is not a performance obligation. Procurement is an activity that is necessary for the entity to obtain control of the promised materials and equipment and then to transfer them to the customer. Because the customer obtains control of the materials and equipment only as they are installed, they are transferred to the customer at the same time as the related installation services. Hence, the entity accounts for the materials and equipment together with the related installation service (in accordance with paragraph 24).

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*...continued***Example 11—Construction contract**

During construction, the entity performs various tasks including site preparation, foundation development, structure erection, piping, wiring and site finishing (for example, paving a parking lot and landscaping). The customer could contract separately with other entities to perform each of those tasks. However, some of the tasks are highly interrelated, which requires the entity to provide a significant contract management service. That service includes managing and coordinating those tasks and covering the risk that those tasks do not combine to provide the integrated construction services for which the customer has contracted.

The contract management service is not distinct. Similar services are not sold separately because the entity is integrating, and covering the risks of, a unique combination of tasks. The contract management service has a distinct function, but it does not have a distinct profit margin. The entity can separately identify the resources to provide the contract management service. However, the contract management service is not subject to distinct risks because the risks are inseparable from the risks of the related tasks.

Because the contract management service is not distinct, the entity combines that service with the related tasks with inseparable risks. The entity identifies distinct risks for site preparation and site finishing. Hence, the entity accounts for those services as separate performance obligations. The remaining construction tasks are accounted for as a single performance obligation.

The entity would account for the performance guarantee as a warranty as discussed in paragraphs B13–B19.

Satisfaction of performance obligations (paragraphs 25–33)

B44 Paragraph 25 requires an entity to recognise revenue when it satisfies a performance obligation identified in accordance with paragraphs 20–24 by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service. An entity shall consider the following guidance when applying that requirement:

- (a) software licence (paragraph B45);
- (b) shipment of a product with risk of loss (paragraph B46);
- (c) sale and repurchase of an asset (paragraphs B47–B53);

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- (d) consignment arrangements (paragraphs B54–B57);
- (e) bill-and-hold arrangements (paragraphs B58–B62);
- (f) determining whether goods or services are transferred continuously (paragraphs B63–B68); and
- (g) customer acceptance (paragraphs B69–B73).

Software licence

B45 The following example illustrates how an entity would determine when it satisfies a performance obligation when the entity licenses or grants a customer the right to its intellectual property.

Example 12—Software licence

An entity has previously licensed, on a non-exclusive basis, Product X to a customer on a compact disc that also included a copy of Products Y and Z. Each product requires an access code for the customer to use the software. Upon delivery of the compact disc, the entity provided the access code to Product X, but not for Products Y and Z.

At the reporting date, the entity licenses Product Y to the customer but provides the access code to Product Y after the reporting date.

In this example, the customer does not obtain control of the rights to Product Y at the reporting date because the customer cannot use Product Y until it obtains the access code. Therefore, the entity would recognise revenue for Product Y when the customer obtains the access code and, hence, the entity satisfies its performance obligation.

Shipment of a product with risk of loss

- B46 The following example illustrates how an entity would identify performance obligations and determine when it satisfies them if the entity retains the risk of loss during shipment of the product.

Example 13—Free on board shipping point and risk of loss

An entity enters into a contract to sell a product to a customer. The delivery terms are free on board shipping point (ie legal title to the product passes to the customer when the product is handed over to the carrier). The entity uses a third-party carrier to deliver the product. In accordance with the entity’s past business practice, the entity will provide the customer with a replacement product, at no additional cost, if a product is damaged or lost while in transit. The entity has determined that its past business practice of replacing damaged products has implicitly created an enforceable obligation.

Hence, the entity has performance obligations to provide the customer with a product and to cover the risk of loss during transit. The customer obtains control of the product at the point of shipment. Although it does not have physical possession of the product at that point, it has legal title and therefore can sell the product to (or exchange it with) another party. The entity is also precluded from selling the product to another customer.

In this example, the additional performance obligation for risk coverage does not affect when the customer obtains control of the product. However, it does result in the customer’s receiving a service from the entity while the product is in transit. Hence, the entity has not satisfied all of its performance obligations at the point of shipment and would not recognise all of the revenue at that point. Some revenue would be recognised as it covers the risk of loss during transit (subject to materiality).

Sale and repurchase of an asset

- B47 Sometimes an entity sells an asset and also enters into a repurchase agreement (either in the same contract or in another contract). The repurchased asset may be the asset that was originally sold to the customer, an asset that is substantially the same as that asset, or another asset of which the asset that was originally sold is a component.
- B48 Repurchase agreements come in three main forms:
- (a) an entity’s unconditional obligation to repurchase the asset (a forward);

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- (b) an entity's unconditional right to repurchase the asset (a call option); and
 - (c) a customer's unconditional right to require the entity to repurchase the asset (a put option).
- B49 If an entity has an unconditional obligation or unconditional right to repurchase the asset (a forward or a call option), the customer is constrained in its ability to direct the use of, and receive the benefit from, the asset. Hence, the customer does not obtain control of the asset (even though the customer may have physical possession of the asset), and the entity shall account for the sale and repurchase agreement as:
 - (a) a right of use in accordance with IAS 17, if the entity repurchases the asset for an amount that is less than the original sales price of the asset; or
 - (b) a financing arrangement, if the entity repurchases the asset for an amount that is equal to or more than the original sales price of the asset.
- B50 When comparing the repurchase price with the sales price, an entity shall adjust the prices to reflect the effects of the time value of money, if material.
- B51 If the sale and repurchase agreement is a financing arrangement, the entity shall continue to recognise the asset and shall recognise a financial liability for any consideration received from the customer. The entity shall recognise the difference between the amount of consideration received from the customer and the amount of consideration paid to the customer as interest and, if applicable, holding costs (for example, insurance).
- B52 If a customer has the unconditional right to require the entity to repurchase the asset (a put option), the customer obtains control of the asset and the entity shall account for the agreement similarly to the sale of a product with a right of return as discussed in paragraphs B5–B12. The following example illustrates how an entity would account for the sale of an asset with a put option.

Example 14—Sale and repurchase of an asset

An entity sells an asset for CU100,000 and grants the customer the option to return the asset and receive a refund of CU100,000. The cost of the asset is CU70,000. The entity estimates a 50 per cent probability that the asset will be returned.

Upon transfer of control of the asset, the entity would:

(a) derecognise the asset:

Dr cost of sales	CU70,000	
Cr inventory		CU70,000

(b) recognise revenue and a repurchase liability:

Dr cash	CU100,000	
Cr repurchase liability	CU50,000	(CU100,000 × 50%)
Cr revenue	CU50,000	(CU100,000 – CU50,000)

(c) recognise an asset for its right to recover the asset on settling the repurchase liability:

Dr right to receive asset	CU35,000	(CU70,000 × 50%)
Cr cost of sales	CU35,000	

If the customer exercises its option to require the entity to repurchase the asset, the entity would:

(a) settle the repurchase liability and adjust the revenue previously recognised:

Dr repurchase liability	CU50,000	
Dr revenue	CU50,000	
Cr cash		CU100,000

(b) recognise the repurchased asset:

Dr inventory	CU70,000	
Cr right to receive asset	CU35,000	
Cr cost of sales	CU35,000	

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- B53 If the terms of the put and related facts and circumstances make it virtually certain that the customer will exercise the put option (for example, because the customer is a financial institution and would incur a significant loss if it does not exercise the option), the entity would recognise a repurchase liability for virtually the full amount of consideration received from the customer.

Consignment arrangements

- B54 Some entities deliver products to other parties (for example, dealers or distributors) on a consignment basis. Those arrangements help the entity to move its inventory closer to the point of sale to end customers and provide the other party with a wider range of inventory than might otherwise be practicable.
- B55 When an entity delivers a product to another party such as a dealer or a distributor for sale to end customers, an entity shall evaluate whether the dealer or distributor has obtained control of the product at that point in accordance with paragraphs 26–31.
- B56 Typically, inventory on consignment is owned by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer, or until a specified period expires. Until that point, the entity typically is able to require the return of the products or transfer them to another dealer. Moreover, the dealer typically does not have an unconditional obligation to pay for the products (although it might be required to pay a deposit). Accordingly, the entity would not recognise revenue upon delivery of the products to the dealer.
- B57 If the dealer or distributor obtains control of the product before transferring the product to an end customer, it is a principal as discussed in paragraphs B20–B23 and shall recognise revenue when its customer obtains control of the product. If the dealer or distributor does not obtain control of the product, then it is an agent as discussed in paragraphs B20–B23 and shall recognise revenue when it has provided the service of arranging for the transfer of the product.

Bill-and-hold arrangements

- B58 In some contracts, an entity bills a customer for a product but does not ship the product until a later date (a bill-and-hold arrangement). For example, a customer may request an entity to enter into such contracts because of a lack of available space for the product or because of delays in its production schedules or because it has more than sufficient inventory in its distribution channel.

- B59 An entity determines when it has satisfied its performance obligation to transfer a product by evaluating when the customer obtains control of that product in accordance with paragraphs 26–31. In most contracts, that will be when the product is either delivered to the customer’s delivery site or shipped to the customer, depending on the terms of the contract, including delivery or shipping terms. However, a customer may have obtained control of a product even though that product remains in the physical possession of the entity. In such cases, the customer has the ability to direct the use of, and receive the benefit from, the product even though it has decided to not exercise its right to use that product. Consequently, the entity does not have the ability to direct the use of, and receive the benefit from, the product. Instead the entity provides custodial services to the customer over the customer’s asset.
- B60 Accordingly, for a customer to have obtained control of a product in a bill-and-hold arrangement:
- (a) the customer must have requested the contract to be on a bill-and-hold basis;
 - (b) the product must be identified separately as the customer’s;
 - (c) the product currently must be ready for delivery at the location and time specified, or to be specified, by the customer; and
 - (d) the entity cannot use the product or sell it to another customer.
- B61 In addition to evaluating whether the customer has obtained control of a product in a bill-and-hold arrangement in accordance with paragraphs 26–31, the entity also considers the conditions in paragraph 10 to assess whether a contract exists.
- B62 If an entity recognises revenue from the sale of a product on a bill-and-hold basis, the entity shall consider whether the custodial services are a material separate performance obligation to which some of the transaction price shall be allocated.

Determining whether goods or services are transferred continuously

- B63 In most contracts, it is straightforward to determine whether an entity has promised to transfer goods or services continuously or to transfer them at a point in time. In some contracts, however, it can be difficult to make that determination, particularly when an entity promises to produce, manufacture or construct an asset specifically for a customer (for example, construction-type, production-type and software

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development contracts). That determination affects whether an entity satisfies a performance obligation (and recognises revenue) continuously throughout the contract or only at the end of the contract when the customer obtains control of the completed asset.

- B64 In such cases, an entity shall determine whether it has promised to transfer goods or services continuously by evaluating whether the customer controls the asset as it is produced, manufactured or constructed. Therefore, in accordance with paragraphs 26–31, the entity shall consider whether the customer has the ability to direct the use of, and receive the benefit from, the work in progress (rather than the completed asset). If the customer has that ability, the contract is to transfer goods or services continuously to the customer, and the entity would recognise revenue continuously to depict that transfer.
- B65 If the customer does not control the asset as it is produced, manufactured or constructed, the contract is to transfer a completed asset. In that situation, an entity shall recognise revenue only when the customer obtains control of the completed asset.
- B66 The following example illustrates situations in which the entity's contract is to provide services and those in which the entity's contract is to provide a completed asset.

Example 15—Manufacturing services versus manufactured equipment

Scenario 1—manufacturing services

A manufacturer enters into a contract with a customer on 1 January to build highly customised equipment to be delivered to the customer on 31 December for a fixed price of CU240,000. Non-refundable progress payments are made on a quarterly basis for work completed during the quarter.

The equipment is manufactured at the entity's facility. Because the equipment is customised for the particular customer, the customer is highly involved in specifying the design of the equipment and the manufacturing process. For instance, the customer can specify changes to the equipment throughout the manufacturing process for additional consideration. Legal title to the equipment passes to the customer upon delivery of the equipment. If the contract is terminated before manufacturing of the equipment is finished, the customer retains the part-completed equipment and must pay for any work completed to date.

In this example, the terms of the contract and all the related facts and circumstances indicate that the customer controls the equipment as it is manufactured. The customer has an unconditional obligation to pay throughout the contract as evidenced by the required progress payments (with no refund of payment for any work performed to date) and by the requirement to pay for any partially completed equipment in the event of contract termination. In addition, the customer specifies the design of the equipment and has involvement in the manufacturing process. The customer also has the ability to take possession of the equipment during manufacturing and engage another entity to complete the manufacturing. Consequently, the manufacturer cannot direct the use of, and receive the benefit from, the equipment. Although the customer does not obtain legal title of the equipment until delivery of the complete or part-complete equipment, the entity's retention of title is a protective right, and not an indicator that the entity has retained control.

Consequently, the entity's performance obligation is to provide the customer with materials and services continuously because the customer controls the equipment throughout the manufacturing process. Paragraph 33 provides guidance on selecting a revenue recognition method for that performance obligation.

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Example 15—Manufacturing services versus manufactured equipment

Scenario 2—manufactured equipment

On 1 January, a manufacturer enters into a contract with a customer for equipment to be delivered to the customer on 31 December for a fixed price of CU240,000. The customer is obliged to make quarterly payments of CU60,000.

The equipment is manufactured at the entity's facility and is of a standard design, although the entity typically manufactures equipment only when it has a contract. Hence, the customer is able to specify only minor aspects of the design of the equipment. Legal title to the equipment passes to the customer upon delivery of the equipment. If the customer cancels the contract before the equipment is delivered, the customer compensates the entity for any loss of profit on sale of the equipment to another customer.

In this example, the terms of the contract and all the related facts and circumstances indicate that the customer does not obtain control of the equipment until it is delivered. The customer is not involved in the design of the equipment and does not have managerial involvement throughout the contract. Also, the customer cannot take possession of the equipment until it is ready for delivery. Although the customer has unconditional obligations to make payments to the entity over the duration of the contract, those payments would be recoverable in full if the entity did not deliver the equipment. The customer does not have the ability to limit the entity's rights to the equipment and, therefore, does not direct the use of, and receive the benefit from, any work completed to date. Although the equipment is being manufactured for the customer, the entity could sell the equipment to another customer and manufacture additional equipment for transfer to the customer on 31 December.

Consequently, the entity's performance obligation is to provide the customer with equipment because the customer does not control the equipment until its delivery.

B67 The following example illustrates a continuous transfer of services.

Example 16—Consulting services

On 1 January, an entity enters into a six-month fixed price contract with a customer to analyse the customer's historical sales trends in order to assist the customer in developing its budget. The entity promises to share findings with the customer each month and to provide the customer with a final report at the end of the contract. The customer promises to pay CU10,000 per month. The customer can change the specification of its requirements throughout the contract and has the right to obtain any analysis prepared by the entity.

In this example, the terms of the contract and all the related facts and circumstances indicate that the customer has the ability to direct the use of, and receive the benefit from, the consulting services as they are performed. The customer has an unconditional obligation to pay throughout the contract as evidenced by the non-refundable progress payments. Additionally, the customer specifies the services to be provided throughout the contract and, hence, directs the nature of the services to be performed, which affects the entity's final report.

Consequently, the entity's performance obligation is to provide the customer with services continuously during the six months of the contract.

- B68 The following example illustrates a contract in which the entity promises to transfer a completed asset.

Example 17—Sale of apartments

An entity is developing residential real estate and begins to market individual apartments during their construction. An entity enters into a contract with a customer for the sale of a specific apartment. The customer pays a deposit that is refundable only if the entity fails to deliver the completed apartment in accordance with the contract. The remainder of the purchase price is paid on completion of the contract when the customer obtains possession of the apartment. The customer is able to choose from a range of standardised options specified by the entity (for example, flooring, colour schemes and fixtures).

In this example, the terms of the contract and all the related facts and circumstances indicate that the customer obtains control of the apartment on completion of the contract. The customer obtains title and physical possession of the apartment only on completion of the contract. Additionally, the customer cannot specify major structural changes to the design of the apartment, which suggests that the apartment is not a customer-specific asset.

Consequently, the entity's performance obligation is to provide the customer with a completed apartment because the customer does not control the apartment until completion of the contract.

Customer acceptance

- B69 Customer acceptance clauses are substantive contractual terms intended to ensure the customer's satisfaction with the goods or services promised in a contract. Without the customer's acceptance, the entity may not be entitled to consideration or may be required to take remedial action.
- B70 An entity shall consider the effect of acceptance clauses in determining whether a customer has obtained control of a promised good or service.
- B71 If an entity can objectively determine that a good or service has been transferred to the customer in accordance with the agreed specifications in the contract, then customer acceptance is a formality that would not affect an entity's determination of when the customer has obtained control of the good or service. For example, if the customer acceptance clause is based on meeting specified size and weight characteristics, an entity would be able to determine whether those criteria have been met before receiving the customer's acceptance. The entity's experience with

contracts for similar goods or services may provide evidence that a good or service provided to the customer is in accordance with the agreed specifications in the contract. If revenue is recognised before customer acceptance, the entity must still consider whether there are any remaining performance obligations (for example, installation of equipment) and evaluate whether to account for them separately.

- B72 If, however, an entity cannot objectively determine that the good or service provided to the customer is in accordance with the agreed specifications in the contract, then the entity would not be able to conclude that the customer has obtained control until the entity receives the customer's acceptance. That is because the entity cannot determine that the customer has the ability to direct the use of, and receive the benefit from, the good or service. For example, suppose an entity enters into a contract to provide one of its products, modified so that it can be integrated into the customer's new production line, and the customer's acceptance in the contract is subject to the customer's judgement of whether that product has been satisfactorily integrated. Further suppose that the entity has never previously modified its equipment in that way. In that case, the customer's written acceptance indicates the point at which the customer obtains control of the product.
- B73 In some contracts, the effect of the acceptance clause is that an entity has delivered products to the customer for trial or evaluation purposes without the customer committing to pay any consideration. In some of those cases, the customer is contractually required to accept the product if it does not return it by a specified date. Hence, in those contracts the product has not been transferred to the customer until either the customer accepts the product or the specified date passes.

Determining the transaction price (paragraphs 35–49)

- B74 Paragraph 35 requires an entity to determine the transaction price. An entity shall consider the effects of the following when determining the transaction price:
- (a) variable consideration (paragraphs B75–B77);
 - (b) collectibility (paragraphs B78–B80);
 - (c) the time value of money (paragraphs B81–B84); and
 - (d) consideration payable to the customer (paragraph B85).

Variable consideration

- B75 Paragraph 38 states that an entity shall recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated.
- B76 The following example illustrates a situation in which part of the total consideration amount cannot be reasonably estimated.

Example 18—Management fees based on an index

On 1 January, an entity enters into a contract with a client to provide fund management services for one year. The customer is required to pay a fixed quarterly amount plus 10 per cent of any increase in the fund's value relative to an observable index at the end of the year.

The entity has entered into many similar contracts previously. However, the entity determines that its experience with those types of contracts is not relevant to the contract because the circumstances surrounding those types of contracts could change significantly. The variable consideration amount is highly susceptible to external factors (market risk), the uncertainty is not expected to be resolved until the end of the year, and the contract has a large number of possible consideration amounts.

Hence, the transaction price would be limited to the fixed amount of consideration until the end of the year.

- B77 The following example illustrates a situation in which an entity has experience with similar types of contracts and that experience is relevant to the contract.

Example 19—Consulting services with a performance bonus/penalty

A consultant enters into a contract and promises to provide cost management consulting services to a client over six months. The client promises to pay CU20,000 at the beginning of each month. At the end of the contract, the consultant either will give the client a refund of CU10,000 or will be entitled to an additional CU10,000, depending on the client's level of cost savings.

The consultant has extensive experience with similar types of contracts and that experience is relevant to the contract. The uncertainty will be resolved in a relatively short period of time, the contract does not have a large number of possible consideration amounts, and the consideration amount is not highly susceptible to external factors (ie the amount is largely determined by the consultant's performance). Hence, at contract inception, the consultant estimates the transaction price by identifying the following possible consideration amounts and their related probabilities:

Possible consideration amounts	Probabilities	Expected consideration
CU130,000 (CU20,000 × 6 + CU10,000)	80%	CU104,000
CU110,000 (CU20,000 × 6 – CU10,000)	20%	CU22,000
Transaction price at contract inception		CU126,000

After three months, circumstances change and the consultant revises its estimates of the probabilities of the possible consideration amounts. Hence, the estimated transaction price changes as follows:

Possible consideration amounts	Probabilities	Expected consideration
CU130,000 (CU20,000 × 6 + CU10,000)	60%	CU78,000
CU110,000 (CU20,000 × 6 – CU10,000)	40%	CU44,000
Transaction price after three months		CU122,000

At the end of the contract, the consultant receives the additional consideration of CU10,000.

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Example 19—Consulting services with a performance bonus/penalty

At contract inception, the consultant would allocate the transaction price of CU126,000 to the performance obligation to provide consulting services. Because those services are provided evenly over the six months, the consultant would recognise revenue of CU21,000 per month (CU126,000 ÷ 6 months).

Because the client pays CU20,000 per month (CU1,000 less than the revenue recognised), the consultant would recognise a contract asset of CU1,000 in the first month to reflect the revenue recognised in excess of its unconditional rights to consideration. That contract asset would increase to CU3,000 by the end of the third month.

After three months, the estimated transaction price decreases by CU4,000 (CU126,000 – CU122,000). Because half of the performance obligation has been satisfied (3 months ÷ 6 months), half of the CU4,000 decrease in the transaction price would be allocated to the satisfied performance obligation. Hence, the consultant would recognise revenue of CU61,000 for the first three months (CU122,000 × 3 months ÷ 6 months). The contract asset and revenue would decrease by CU2,000 (half of the CU4,000 decrease in the transaction price) at the time of the change in estimate.

At the end of the contract, the transaction price becomes a fixed amount of CU130,000. Therefore, the consultant recognises revenue of CU8,000 (CU130,000 – CU122,000).

If the consultant could not reasonably estimate the probability of each outcome during the contract, the transaction price would not include uncertain amounts. Hence, the transaction price would be CU110,000 until the uncertainty is resolved.

Collectibility

- B78 In many contracts, the effect of the customer's credit risk on the transaction price is immaterial. In such cases, an entity measures the transaction price at the original invoice amount.
- B79 However, in some contracts, although the contract satisfies the conditions in paragraph 10, there is a possibility that the customer might not pay the consideration for reasons other than the entity's non-performance. That includes situations in which an entity enters into contracts with customers and expects a proportion of them to default, but does not know which specific customers will default. In such contracts, paragraph 43 requires the entity to reduce the amount of

promised consideration to reflect the possibility that it will not receive some or all of the promised consideration. Hence, the transaction price shall reflect the probability-weighted amount of consideration the entity expects to receive from the customer. If such an amount cannot be reasonably estimated in accordance with paragraph 38, no revenue shall be recognised until either cash is collected or an amount can be reasonably estimated.

Example 20—Customer credit risk

An entity enters into a contract with a customer to provide goods for CU1,000. Payment is due one month after the goods are transferred to the customer.

The entity assesses, on the basis of its experience with contracts with similar characteristics, that there is a 10 per cent chance that the customer will not pay the consideration. Hence, the transaction price is CU900 [(90% × CU1,000) + (10% × CU0)]. When the entity transfers the goods to the customer and satisfies its performance obligation, it recognises a receivable and revenue of CU900.

After transferring the goods to the customer, the financial condition of the customer deteriorates and the entity determines that the receivable due from that customer is further impaired by CU60. The entity recognises the impairment as an expense rather than as a reduction in revenue.

- B80 If the entity enters into a group of similar contracts in which the promised consideration is required to be adjusted to reflect the customer's credit risk, the entity might recognise revenue on an individual contract basis in the amount of the invoiced amount. The entity would then adjust the initial measurement of the receivables and recognise a corresponding reduction of revenue for the group of contracts.

The time value of money

- B81 Paragraph 44 requires an entity to adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component. In a contract with a material financing component, the amount of promised consideration comprises both of the following:
- (a) the cash selling price of the goods or services at the point that they are transferred to the customer (assuming there is no discount to

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the cash selling price agreed with the customer for any other reason); and

- (b) a financing component, interest either to the customer or from the customer.

B82 An entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer. That rate would reflect the credit characteristics of the parties to the contract as well as any collateral or security provided by the customer or the entity, which might include goods transferred in the contract. An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the cash sales price of the good or service.

B83 The following example illustrates how an entity would adjust the amount of promised consideration when the customer pays in arrears.

Example 21—Customer payment in arrears

An entity sells a product to a customer for a CU10,000 payment due two years after the product is transferred to the customer. The entity determines that the discount rate in a financing transaction between the entity and the customer that did not involve the provision of other goods or services would be 6 per cent. When the entity transfers the product to the customer, it recognises revenue of CU8,900 $[CU10,000 \div (1.06 \times 1.06)]$. The entity accounts for its unconditional rights to consideration (and interest) in accordance with IFRS 9 *Financial Instruments*.

B84 The following example illustrates how an entity would adjust the amount of promised consideration when the customer pays in advance.

Example 22—Customer payment in advance

An entity sells a product to a customer for a CU8,000 payment due one year before the product is transferred to the customer. On receipt of the customer's payment, the entity recognises a contract liability of CU8,000. The entity determines that the discount rate in a financing transaction between the entity and the customer that did not involve the provision of other goods or services would be 10 per cent. During the year before the product is transferred to the customer, the entity recognises interest expense of, and increases the measurement of the performance obligation by, CU800 $[(CU8,000 \times 1.10) - CU8,000]$. Therefore, immediately before the performance obligation is satisfied the carrying amount of the contract liability is CU8,800 $(CU8,000 + CU800)$. The entity recognises revenue of CU8,800 when it transfers the product to the customer.

Consideration payable to the customer

- B85 When an entity pays consideration to the customer, paragraph 48 requires the entity to determine whether that consideration is a reduction of the transaction price, a payment for a distinct good or service, or a combination of both. The following examples illustrate how an entity would make that determination.

Example 23—Slotting fees

An entity sells 1,000 units of a product to a reseller for CU10,000. In addition, the entity pays CU1,000 to the reseller in exchange for a product placement service. That service includes specified services of stocking, displaying and supporting the products. The entity determines, on the basis of similar transactions in the marketplace, that the fair value of the product placement service is CU600.

The entity must assess whether the CU1,000 payment to the customer is a reduction of the transaction price, a payment in exchange for a distinct good or a service, or a combination of both.

Although the product placement service is not sold separately (ie without related products), the service is distinct because it has a distinct function and a distinct profit margin. Hence, the payment to the reseller for the product placement service would result in the entity recognising an expense in the amount of the fair value of the service (CU600). The remaining CU400 (CU1,000 payment to reseller – CU600 fair value of the service) would result in a reduction of the transaction price. The entity would recognise revenue of CU9,600 (CU10,000 – CU400) when the reseller obtains control of the products.

Example 24—Sales incentive

A manufacturer sells 1,000 units of a product to a retailer for CU8 per unit. The retailer sells the product direct to customers for CU10 per unit. The manufacturer issues coupons for a CU1 discount direct to customers via newspapers and flyers. The retailer accepts the coupons from customers and, thus, the customer pays CU10 per unit without a coupon or CU9 per unit with a coupon. The retailer submits all coupons to the manufacturer and receives CU1 per coupon submitted. At the time of transfer of products to the retailer, the manufacturer concludes that it cannot reasonably estimate the number of coupons to be redeemed.

The manufacturer receives no distinct good or service in exchange for the coupons. Because the manufacturer cannot reasonably estimate the number of coupons to be redeemed, the transaction price is CU7,000 (CU8,000 less maximum discount of CU1,000) in accordance with paragraphs 38–41. If the manufacturer issues the coupons before it transfers the products to the retailer, it would recognise revenue of CU7,000 when the products are transferred to the retailer (in accordance with paragraph 49).

Allocating the transaction price to separate performance obligations (paragraphs 50–53)

- B86 Paragraph 50 requires an entity to allocate the transaction price to performance obligations in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations at contract inception. The following guidance illustrates how an entity would allocate the transaction price when an entity grants a customer an option to acquire additional goods or services that is determined to be a separate performance obligation as discussed in paragraphs B24–B26.
- B87 The stand-alone selling price for a customer's option to acquire additional goods or services often is not directly observable and must be estimated. That estimate shall reflect the discount the customer would obtain when exercising the option, adjusted for the following:
- (a) any discount that the customer could receive without exercising the option; and

- (b) the likelihood that the option will be exercised.

Example 25—Estimating the stand-alone selling price of an option for additional goods or services

Consider again Example 5. The entity could estimate the stand-alone selling price of the discount voucher as follows.

The entity estimates an 80 per cent likelihood that a customer will redeem the voucher and that a customer will, on average, purchase CU50 of additional products. Because the entity intends to offer a 10 per cent discount to all customers as part of a seasonal promotion, the 40 per cent discount that the customer would obtain when exercising the voucher needs to be reduced by 10 percentage points to 30 per cent to reflect the incremental value of the discount to the customer.

Hence, the entity's estimated stand-alone selling price of the discount voucher is CU12 (CU50 average purchase of additional products × 30% incremental discount × 80% likelihood of exercising the option).

If the stand-alone selling price of Product A is CU100, the entity allocates CU10.7 {CU100 × [12 ÷ (12 + 100)]} of the CU100 transaction price to the discount voucher.

Example 26—Customer loyalty programme

An entity has a customer loyalty programme that rewards a customer with one customer loyalty point for every CU10 of purchases. Each point is redeemable for a CU1 discount on any future purchases.

During a reporting period, customers purchase products for CU100,000 and earn 10,000 points redeemable for future purchases. The stand-alone selling price of the purchased products is CU100,000. The entity expects 9,500 points to be redeemed. The entity estimates a stand-alone selling price of CU0.95 per point (or CU9,500 total) on the basis of the likelihood of redemption.

The points provide a material right to customers that they would not receive without entering into a contract. Hence, the entity concludes that the points are a separate performance obligation.

The entity allocates the transaction price to the product and the points on a relative stand-alone selling price basis as follows:

Product	CU91,324	(CU100,000 × CU100,000 ÷ CU109,500)
Points	CU8,676	(CU100,000 × CU9,500 ÷ CU109,500)

continued...

*...continued***Example 26—Customer loyalty programme**

At the end of the first reporting period, 4,500 of the points have been redeemed, and the entity expects 9,500 points to be redeemed in total. The entity recognises revenue of CU4,110 [(4,500 points ÷ 9,500 points) × CU8,676].

During the second reporting period, an additional 4,000 points are redeemed (cumulative points redeemed are 8,500). The entity expects that 9,700 points will be redeemed in total. The cumulative revenue that the entity recognises is CU7,603 [(8,500 ÷ 9,700) × CU8,676]. The entity has recognised CU4,110 in the first reporting period so it recognises revenue of CU3,493 (CU7,603 – CU4,110) in the second reporting period.

In the third reporting period, an additional 1,200 points are redeemed (cumulative points redeemed are 9,700). The entity expects that no additional points will be redeemed. The entity has already recognised revenue of CU7,603, so it recognises the remaining revenue of CU1,073 (CU8,676 – CU7,603).

B88 If a customer has the option to acquire additional goods or services that provides it with a material right and those goods or services are:

- (a) similar to the original goods or services in the contract; and
- (b) provided in accordance with the terms of the original contract;

then an entity may, as a practical alternative to estimating the stand-alone selling price of the option, allocate the transaction price to the optional goods or services by reference to the goods or services expected to be provided and the corresponding expected consideration. Typically, those types of options are for contract renewals.

Example 27—Maintenance services with a renewal option

An entity enters into 100 contracts to provide one year of maintenance services for CU1,000 per contract. At the end of the year, each customer has the option to renew the contract for a second year by paying an additional CU1,000. Customers who renew for a second year are also granted the option to renew for a third year under the terms of the original contract.

The entity concludes that the renewal option provides a material right to the customer because the entity expects to undertake progressively more maintenance work each year if a customer renews. Part of each customer's payment of CU1,000 in the first year is a non-refundable prepayment of services to be provided in a subsequent year. Hence, the option is a separate performance obligation.

The renewal option is for a continuation of maintenance services, and those services are provided in accordance with the terms of the original contract. Hence, rather than determining the stand-alone selling prices for the renewal options directly, the entity could allocate the transaction price by determining the consideration that it expects to receive in exchange for all the services that it expects to provide.

The entity expects 90 per cent of customers to renew at the end of the first year and 90 per cent of those customers to renew at the end of the second year.

The entity determines the amount to allocate to the option at the end of the first and second years as follows.

The expected amount of consideration for each contract that is renewed twice is CU2,710 [CU1,000 + (90% × CU1,000) + (90% × 90% × CU1,000)]. The entity determines that recognising revenue on the basis of costs incurred relative to total expected costs would best depict the transfer of services to the customer. For a contract that is renewed twice and extended to three years, the estimated costs in Years 1–3 are:

Year 1	CU600
Year 2	CU750
Year 3	CU1,000

continued...

*...continued***Example 27—Maintenance services with a renewal option**

Accordingly, the pattern of revenue recognition for each contract is as follows:

	Expected costs adjusted for likelihood of contract renewal		Allocation of consideration expected	
Year 1	CU600	(CU600 × 100%)	CU780	(CU600 ÷ CU2,085 × CU 2,710)
Year 2	CU675	(CU750 × 90%)	CU877	(CU675 ÷ CU2,085 × CU 2,710)
Year 3	CU810	(CU1,000 × 81%)	CU1,053	(CU810 ÷ CU2,085 × CU 2,710)
	<u>CU2,085</u>		<u>CU2,710</u>	

Therefore, at the end of the first year, the entity allocates to the option CU22,000 of the consideration received to date [cash of CU100,000 less revenue recognised of CU78,000 (CU780 × 100)]. The entity allocates CU24,300 to the option at the end of the second year [cumulative cash of CU190,000 less cumulative revenue recognised of CU165,700 (CU78,000 + CU877 × 100)].

Contract costs (paragraphs 57–63)

- B89 Paragraph 57 states that if the costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with another IFRS (for example, inventory; property, plant and equipment; and capitalised software), an entity shall recognise an asset if specified criteria are met.

- B90 The following example illustrates how an entity would apply that guidance.

Example 28—Outsourcing services with set-up activities	
An entity enters into a contract to outsource a customer's information technology data centre for five years. The entity incurs selling commission costs of CU10,000 to obtain the contract. Before providing the services, the entity designs and builds a technology platform that interfaces with the customer's systems. That platform is not transferred to the customer.	
The customer promises to pay a fixed fee of CU20,000 per month.	
The CU10,000 costs of obtaining the contract are recognised as expenses when incurred.	
The initial costs incurred to set up the technology platform are as follows:	
Design services	CU40,000
Hardware and software	CU210,000
Migration and testing of data centre	CU100,000
Total	CU350,000
The initial set-up costs relate primarily to activities to fulfil the contract but do not transfer goods or services to the customer. The entity would account for the initial set-up costs as follows:	
(a) Hardware costs—accounted for in accordance with IAS 16 <i>Property, Plant and Equipment</i> .	
(b) Software costs—accounted for in accordance with IAS 38 <i>Intangible Assets</i> .	
(c) Costs of the design, migration and testing of the data centre—these costs would be considered for capitalisation in accordance with paragraph 57. Any resulting asset would be amortised as the entity provides the services outsourced by the customer.	

Presentation (paragraphs 64–68)

- B91 Paragraph 64 specifies that when either party to a contract has performed, the entity shall recognise the contract either as a contract asset or as a contract liability. Paragraph 66 specifies that an entity shall present an unconditional right to consideration as a receivable. The following example illustrates those requirements.

Example 29—Presentation

In each of the following scenarios, the entity determines that the effects of the customer's credit risk and the time value of money are not material.

Scenario 1—receivable

On 1 January, an entity enters into a contract to transfer a product to a customer on 31 March. The contract requires the customer to pay the consideration of CU1,000 on 30 April. The entity transfers the product on 31 March.

On satisfying the performance obligation on 31 March and obtaining an unconditional right to consideration:

Dr receivable	CU1,000	
		Cr revenue
		CU1,000

On receiving the cash:

Dr cash	CU1,000	
		Cr receivable
		CU1,000

Scenario 2—contract liability and receivable

On 1 January, an entity enters into a contract to transfer a product to a customer on 31 March. The contract requires the customer to pay the consideration of CU1,000 in advance on 31 January. The contract is non-cancellable. The customer pays on 15 February, and the entity transfers the product on 31 March.

On obtaining an unconditional right to consideration on 31 January:

Dr receivable	CU1,000	
		Cr contract liability
		CU1,000

On receiving the cash on 15 February:

Dr cash	CU1,000	
		Cr receivable
		CU1,000

continued...

...continued

Example 29—Presentation

On satisfying the performance obligation on 31 March:

Dr contract liability	CU1,000	
Cr revenue		CU1,000

If the contract were cancellable, the entity would not make the above accounting entry on 31 January because it would not have an unconditional right to consideration. Instead, it would recognise the cash and contract liability on 15 February.

Scenario 3—contract asset and receivable

On 1 January, an entity enters into a contract to transfer Products X and Y to a customer. The contract states that payment for the delivery of Product X is contingent on the delivery of Product Y. In other words, the consideration of CU1,000 is due only after the entity has transferred both Products X and Y to the customer. Hence, the entity does not have an unconditional right to consideration (a receivable) until both Products X and Y are transferred to the customer.

The entity identifies separate performance obligations for Products X and Y and allocates CU400 to Product X and CU600 to Product Y, on the basis of their stand-alone selling prices.

On satisfying the performance obligation to transfer Product X:

Dr contract asset	CU400	
Cr revenue		CU400

On satisfying the performance obligation to transfer Product Y:

Dr receivable	CU1,000	
Cr contract asset	CU400	
Cr revenue		CU600

Disclosure (paragraphs 69–83)

- B92 Paragraph 72 requires an entity to present and disclose information in a way that shows how that information relates to information provided in accordance with other IFRSs. The following example illustrates how an entity might comply with that requirement.

Example 30—Relationship to disclosures provided by other IFRSs

An entity has three operating segments that reflect geographical areas A, B and C in accordance with IFRS 8 *Operating Segments*.

The entity decides that the information about the expected timing of satisfaction of remaining performance obligations required by paragraph 78 is best provided by showing it by type of customer as follows:

	Government	Non-government
Not later than one year	X	X
Later than one year but not later than two years	X	X
Later than two years but not later than three years	X	–
Later than three years	X	–
Total	X	X

The entity provides additional information to explain the relationship between this disclosure and that required by IFRS 8 as follows:

Government contracts represent 65 per cent and 25 per cent of the revenues in Operating Segments A and C, respectively. There are no material government contracts in Operating Segment B.

- B93 Paragraph 81 requires an entity to disclose information about the judgements, and changes in judgements, made in applying this [draft] IFRS. An entity shall provide both quantitative information and qualitative information to help users assess the potential effect of those judgements on revenue and cash flows from contracts with customers.

- B94 The following example illustrates how an entity might disclose information about its judgements made in applying this [draft] IFRS.

Example 31—Inputs and assumptions used to estimate stand-alone selling prices

The entity's estimated stand-alone selling price for the software upgrade right included with Product X is CU100. The software upgrade right is specified in the contract but not sold separately. When estimating the stand-alone selling price of the software upgrade right, the entity considered the prices charged by the entity for upgrade rights provided with Product Y and the entity's historical pricing practices, including the relative selling prices of upgrades relative to the prices of the related products.

- B95 In some cases, it may be relatively straightforward for an entity to disclose quantitative information about the inputs and assumptions used and their effect on the amount and timing of revenue recognition.
- B96 In other cases, it may not be practicable to disclose quantitative information about the inputs and assumptions used and their effect on the amount and timing of revenue recognition because of the number of goods or services for which estimated prices are required. In those cases, an entity would describe its methods, inputs, assumptions and estimates. That description might include the following:
- (a) the source of inputs (for example, observable market data, internally generated figures, or a mixture of the two);
 - (b) how often the inputs and assumptions are updated and the date of the latest update; and
 - (c) a description of how past experience and current conditions are taken into account in developing estimates and assumptions.

Appendix C Amendments to other IFRSs

This appendix is an integral part of the [draft] IFRS.

This appendix describes the amendments to other IFRSs that the Board expects to make when it finalises the proposed IFRS X *Revenue from Contracts with Customers*.

Standard	Description of amendment
<ul style="list-style-type: none"> General 	<ul style="list-style-type: none"> Except where otherwise stated, references to 'IAS 18 Revenue' and 'IAS 11 Construction Contracts' are replaced with '[draft] IFRS X Revenue from Contracts with Customers'. Except where otherwise stated, references to 'IAS 18' and 'IAS 11' are replaced with '[draft] IFRS X'.
<ul style="list-style-type: none"> IAS 1 <i>Presentation of Financial Statements</i> 	<ul style="list-style-type: none"> Amend the references to existing IAS 18 revenue recognition requirements to be consistent with the proposals in the exposure draft.
<ul style="list-style-type: none"> IAS 2 <i>Inventories</i> 	<ul style="list-style-type: none"> Delete paragraph 19 relating to 'cost of inventories of a service provider' and the corresponding reference in paragraph 8. Those costs would be accounted for in accordance with the requirements in paragraph 57 of [draft] IFRS X <i>Revenue from Contracts with Customers</i>. Delete the scope exclusion for assets arising from 'construction contracts'.
<ul style="list-style-type: none"> IAS 36 <i>Impairment of Assets</i> 	<ul style="list-style-type: none"> Amend the scope exclusion for 'assets arising from construction contracts' to 'assets arising under paragraph 57 of [draft] IFRS X <i>Revenue from Contracts with Customers</i>'.
<ul style="list-style-type: none"> IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> 	<ul style="list-style-type: none"> Amend the scope exclusion for provisions arising from 'construction contracts' to provisions arising under 'paragraph 54 of [draft] IFRS X <i>Revenue from Contracts with Customers</i>'.
<ul style="list-style-type: none"> IAS 38 <i>Intangible Assets</i> 	<ul style="list-style-type: none"> Add a scope exclusion for contract assets within the scope of [draft] IFRS X <i>Revenue from Contracts with Customers</i>.
<ul style="list-style-type: none"> IAS 40 <i>Investment Property</i> 	<ul style="list-style-type: none"> Delete the scope exclusion in paragraph 9(b) for items arising from 'property being constructed or developed on behalf of third parties'.

EXPOSURE DRAFT JUNE 2010

- IAS 16 *Property, Plant and Equipment*
- IAS 38 *Intangible Assets*
- IAS 40 *Investment Property*
- Amend the requirements for determining the date of disposal and the measurement of consideration to be consistent with the proposals in the exposure draft. Consequently, an entity would derecognise an asset in the scope of IASs 16, 38 or 40 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 amounts that can be reasonably estimated at the date of transfer.
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- IAS 39 *Financial Instruments: Recognition and Measurement*
- IFRS 3 *Business Combinations*
- Amend the reference to ‘cumulative amortisation in accordance with IAS 18’ to be consistent with the proposals in the exposure draft.*
- IAS 39 *Financial Instruments: Recognition and Measurement*
- IFRS 9 *Financial Instruments*
- Move to the relevant financial instruments standard the illustrative examples accompanying IAS 18 on determining which financial service fees are integral parts of the effective interest rate
- IFRS 4 *Insurance Contracts*
- Amend the references to revenue recognition and disclosure requirements to be consistent with the proposals in the exposure draft.
- IFRIC 12 *Service Concession Arrangements*
- Amend the references to IAS 18 revenue recognition requirements to be consistent with the proposals in the exposure draft.

* The project amending IAS 37 may also amend this paragraph.

Approval by the Board of *Revenue from Contracts with Customers* published in June 2010

The exposure draft *Revenue from Contracts with Customers* was approved for publication by the fifteen members of the International Accounting Standards Board.

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June 2010

Basis for Conclusions
Exposure Draft ED/2010/6

Revenue from Contracts with Customers

Comments to be received by 22 October 2010



International
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**Basis for Conclusions on
Exposure Draft
REVENUE FROM CONTRACTS
WITH CUSTOMERS**

Comments to be received by 22 October 2010

ED/2010/6

This Basis for Conclusions accompanies the proposed International Financial Reporting Standard (IFRS) set out in the exposure draft *Revenue from Contracts with Customers* (see separate booklet). Comments on the draft IFRS and its accompanying documents should be submitted in writing so as to be received by **22 October 2010**. Respondents are asked to send their comments electronically to the IASB website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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REVENUE FROM CONTRACTS WITH CUSTOMERS

**Sales of assets that are not an output of an entity's
ordinary activities**

BC248–BC252

Basis for Conclusions on the exposure draft Revenue from Contracts with Customers

This Basis for Conclusions accompanies, but is not part of, the draft IFRS.

Introduction

- BC1 This Basis for Conclusions summarises the considerations of the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) in developing the proposed requirements for revenue from contracts with customers, including the reasons for proposing particular approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.
- BC2 This Basis for Conclusions discusses the following matters:
- (a) background (paragraphs BC3–BC8);
 - (b) scope (paragraphs BC9–BC26);
 - (c) recognition of revenue (paragraphs BC27–BC75);
 - (d) measurement of revenue (paragraphs BC76–BC129);
 - (e) onerous performance obligations (paragraphs BC130–BC148);
 - (f) contract costs (paragraphs BC149–BC158);
 - (g) presentation (paragraphs BC159–BC166);
 - (h) disclosure (paragraphs BC167–BC185);
 - (i) application guidance (paragraphs BC186–BC230);
 - (j) transition (paragraphs BC231–BC235);
 - (k) effective date and early adoption (paragraphs BC236–BC238);
 - (l) costs and benefits (paragraphs BC239–BC247); and
 - (m) consequential amendments (paragraphs BC248–BC252).

Background

- BC3 The IASB and the FASB initiated a joint project to improve the financial reporting of revenue under International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (GAAP). The boards decided that their existing requirements on revenue were in need of improvement because:
- (a) US GAAP comprises broad revenue recognition concepts and numerous requirements for particular industries or transactions that can result in different accounting for economically similar transactions; and
 - (b) the two main revenue standards in IFRSs have different principles and can be difficult to understand and apply to transactions beyond simple transactions. In addition, IFRSs have limited guidance on important topics such as revenue recognition for multiple-element arrangements.
- BC4 The boards decided to eliminate those inconsistencies and weaknesses by developing a single revenue recognition model that would apply to a wide range of industries. The boards concluded that this approach also would:
- (a) provide a more robust framework for addressing revenue recognition issues;
 - (b) improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets; and
 - (c) simplify the preparation of financial statements by reducing the number of requirements to which entities must refer.
- BC5 In December 2008, the boards published for public comment the discussion paper *Preliminary Views on Revenue Recognition in Contracts with Customers*. In that paper, the boards proposed the general principles of a contract-based revenue recognition model with a measurement approach based on an allocation of the transaction price. The boards received more than 200 comment letters in response.
- BC6 After publishing the discussion paper, the boards continued to develop the proposed model. In November and December 2009, the boards held workshops in London, Melbourne, Norwalk and Tokyo to discuss the proposals with preparers from a wide range of industries. Members and

staff of the boards have also been consulting users and preparers across a wide range of industries and jurisdictions around the world. Auditors and securities regulators have also been consulted throughout the development of the proposed requirements.

- BC7 Most respondents have expressed support for the boards' objective to improve the financial reporting of revenue. However, some respondents have questioned whether there is a need to replace existing standards on revenue recognition—in particular those requirements that seem to work reasonably well in practice and provide useful information about the different types of contracts for which they are intended.
- (a) For US GAAP, some question whether a new revenue recognition model is necessary because Accounting Standards Update No. 2009-13 *Multiple-Deliverable Revenue Arrangements* (ASU 2009-13) has resolved some of the issues that the revenue recognition project set out to resolve. Furthermore, the *FASB Accounting Standards Codification*TM (ASC) has simplified the process of accessing and researching existing requirements on revenue.
 - (b) For IFRSs, some believe that the IASB could improve its existing standards by developing additional requirements on critical issues (for example, multiple-element arrangements) without replacing existing standards.
- BC8 The boards acknowledge that it would be possible to improve many existing revenue recognition requirements without replacing them. However, the boards think that, even after the recent changes to US GAAP, the existing requirements in IFRSs and US GAAP would continue to result in inconsistent accounting for revenue and, consequently, would not provide a robust framework for addressing revenue recognition issues in the future. Furthermore, amending existing requirements would fail to achieve one of the goals of the revenue recognition project—to develop a common revenue standard for IFRSs and US GAAP that entities can apply consistently across industries, jurisdictions and capital markets. Because revenue is a crucial number to users of financial statements, the boards think that having a common standard on revenue for IFRSs and US GAAP is an important step towards achieving the goal of a single set of high quality global accounting standards.

Scope (paragraphs 6 and 7)

- BC9 Revenue, as defined in each of the boards' conceptual frameworks, includes revenue arising from contracts with customers and revenue arising from other transactions or events. The proposed requirements would apply only to a subset of revenue—revenue from contracts with customers. The boards had two reasons for developing a model that would apply only to contracts with customers. First, contracts to provide goods or services to customers are important economic phenomena and are the lifeblood of most entities. Secondly, most revenue recognition requirements in IFRSs and US GAAP focus on contracts with customers. Because the boards' objective is to develop a model that can replace most of the existing revenue requirements, that model needs to be at least as broad in scope as those requirements.
- BC10 Revenue that does not arise from a contract with a customer would not be affected by the proposed requirements. For example, in accordance with other standards, revenue would continue to be recognised from changes in the value of biological assets, investment properties and the inventory of commodity broker traders, and from dividends.
- BC11 Some respondents to the discussion paper asked the boards to clarify the existing definitions of revenue or develop a common definition of revenue. The boards decided that the definition of revenue is a matter for consideration in their joint Conceptual Framework project. However, the IASB decided to carry forward into its exposure draft the description of revenue from the IASB *Framework* rather than the definition of revenue from IAS 18 *Revenue*. The IASB noted that the IAS 18 definition refers to 'gross inflow of economic benefits' and the IASB had concerns that some may misread that reference as implying that an entity should recognise as revenue a prepayment from a customer for goods or services. As described in paragraphs BC27–BC34, revenue is recognised in accordance with the proposed requirements only as a result of an entity satisfying a performance obligation in a contract with a customer.

Contracts and customers (Appendix A)

- BC12 The definitions of a *contract* and a *customer* establish the scope of the proposed requirements. The proposed requirements adopt the definitions of a contract and a customer that were proposed in the discussion paper. Respondents generally agreed with those definitions.

Definition of a contract

- BC13 The definition of a contract is based on common legal definitions of a contract in the United States and is similar to the definition of a contract used in IAS 32 *Financial Instruments: Presentation*. Some respondents to the discussion paper suggested that the IASB should adopt a single definition of a contract for both IAS 32 and the proposed requirements. However, the IASB decided not to adopt the IAS 32 definition because that definition implies that contracts can include agreements that are not enforceable by law. Including such agreements would be inconsistent with the boards' proposal that an agreement must be enforceable by law for an entity to recognise the rights and obligations arising from that contract. The IASB also noted that amending the IAS 32 definition posed the risk of unintended consequences in accounting for financial instruments.
- BC14 The definition of a contract emphasises that a contract exists when an agreement between two or more parties creates enforceable obligations between those parties. The boards noted that such an agreement does not need to be in writing to be a contract. Whether the agreed terms are written, oral or evidenced otherwise, if the agreement creates obligations that are enforceable against the parties, it is a contract.
- BC15 Some respondents requested additional guidance to clarify the meaning of *enforceable rights and obligations* in the definition of a contract. The boards noted that whether a contractual right or obligation is enforceable is a question of law and the factors that determine enforceability may differ between jurisdictions. However, the boards decided to specify (in paragraph 10) the attributes of a contract that must be present before an entity would apply the proposed revenue requirements. Those attributes are derived mainly from existing requirements:
- (a) *The contract has commercial substance*—the boards first considered this attribute of a contract when discussing whether revenue should be recognised for non-monetary exchanges. Such transactions have been an area of financial reporting abuse in the past, with entities transferring goods or services back and forth to each other (often for little or no cash consideration), thereby artificially inflating their revenues. Therefore, the boards concluded that an entity should not recognise revenue from a non-monetary exchange if the exchange has no commercial substance. Because other types of contracts also could lack commercial substance, the boards decided that all contracts should have that attribute before revenue can be

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recognised. The boards considered existing guidance on commercial substance when describing it in terms of an entity's expectation of future cash flows changing as a result of the contract.

- (b) *The parties to the contract have approved the contract and are committed to satisfying their respective obligations*—if the parties to a contract have not approved the contract, it is questionable whether the contract is enforceable. In addition, the boards thought this requirement would be useful when there is significant doubt about the collectibility of consideration from the customer. In some cases, that doubt indicates that the parties are not committed to the contract and that the entity does not have an enforceable right to consideration. If the entity does have an enforceable right, then uncertainty about the collectibility of consideration would generally be reflected in the measurement of revenue.
- (c) *The entity can identify each party's enforceable rights regarding the goods or services to be transferred*—the boards decided that an entity would not be able to assess the transfer of goods or services if the entity cannot identify each party's enforceable rights regarding those goods or services.
- (d) *The entity can identify the terms and manner of payment for those goods or services*—the boards decided that an entity would not be able to determine the transaction price if the entity cannot identify the terms and manner of payment in exchange for the promised goods or services.

Definition of a customer

- BC16 The purpose of defining a customer is to distinguish a revenue contract within the scope of the proposed requirements from other contracts into which an entity enters. Some respondents asked the boards to clarify the meaning of *ordinary activities* in the definition of a customer. However, that notion was derived from the existing definitions of revenue. As noted in paragraph BC11, the boards are not reconsidering those definitions in the revenue project.
- BC17 When considering the definition of a customer, the boards observed that revenue could be recognised from transactions with partners or participants in a collaborative arrangement. Those arrangements would be within the scope of the proposed requirements only if the other party to the arrangement meets the definition of a customer. Some industry respondents asked the boards to clarify whether common types of

arrangements in their industries would meet the definition of a contract with a customer. However, the terms and conditions of a specific arrangement may determine the assessment of whether the parties to the arrangement have a supplier-customer relationship or some other relationship (for example, as collaborators or as partners). Therefore, the boards decided that it would not be possible to develop application guidance that would apply uniformly to various industries. An entity would need to consider all relevant facts and circumstances in assessing whether the counterparty meets the definition of a customer. Examples of arrangements in which an entity may need to make such an assessment include:

- (a) collaborative research and development efforts between biotechnology and pharmaceutical entities or similar arrangements in the aerospace and defence industry; and
- (b) arrangements in the oil and gas industry in which partners in an offshore oil and gas field may make payments to each other to settle any differences between their proportionate entitlements to production volumes from the field during a reporting period.

Contracts outside the scope of the proposed requirements (paragraph 6)

BC18 The boards decided to exclude from the scope of the proposed requirements three types of contracts with customers that the boards are addressing in other standard-setting projects:

- (a) leases;
- (b) insurance contracts; and
- (c) financial instruments and other contracts within the scope of the financial instruments standards.

That decision is consistent with the proposals in the discussion paper, which were supported by most respondents.

BC19 The FASB also decided to exclude from the scope of the proposed requirements guarantees (other than product warranties) that are within the scope of ASC Topic 460 on guarantees. The focus of the existing accounting requirements for those guarantee arrangements relates primarily to recognising and measuring a guarantee liability.

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- BC20 Some respondents have reasoned that excluding some contracts with customers from the scope of the proposed requirements could perpetuate the development of industry-specific or transaction-specific revenue requirements, which would be inconsistent with the revenue recognition project's stated objective. The boards disagreed. The proposed requirements provide the boards with a framework for considering revenue issues in other standard-setting projects. Any departure from the proposed requirements in those projects would arise from a decision by the boards that a different basis of accounting for those contracts with customers would provide users of financial statements with more useful information.
- BC21 Many respondents expressed concerns with how the proposed revenue recognition model would apply to construction-type contracts and asked the boards to retain existing requirements for those contracts. After discussing those concerns with various preparers from the construction industry, the boards concluded that this response was in part attributable to a misperception that the proposed model would require completed contract accounting for all contracts currently within the scope of IAS 11 *Construction Contracts* or ASC Subtopic 605-35 on construction-type and production-type contracts. As discussed below, with the proposed requirements, the boards have clarified that not all construction contracts would result in an entity recognising revenue only at contract completion. The boards concluded that there were no reasons to apply a different revenue recognition model to construction contracts; revenue from a construction contract should be recognised as the entity transfers goods or services to the customer. Hence, the boards affirmed the proposal in the discussion paper that the proposed requirements would apply to construction contracts.

Contracts partially within the scope of other standards (paragraph 7)

- BC22 Some contracts with customers would be partially within the scope of the proposed requirements and partially within the scope of other standards (for example, a lease with a distinct service). In those cases, the boards decided it would not be appropriate for an entity to account for the entire contract in accordance with one or the other standard. If that were possible, different accounting outcomes could result depending on whether the goods or services were sold on a stand-alone basis or together with other goods or services.

- BC23 The boards think that the proposed requirements should be the default approach for separating a contract and allocating consideration to each part. However, specific issues could arise in separating contracts that are not within the scope of the proposed requirements. For example, a financial instrument or an insurance contract might require an entity to provide services that are best accounted for in accordance with the standards on financial instruments or insurance contracts.
- BC24 Therefore, the boards decided that if other standards specify how to separate and/or initially measure parts of a contract, an entity should first apply those requirements. Under that approach, which is consistent with the guidance on multiple-element arrangements in ASC Subtopic 605-25, the more specific standard would take precedence in accounting for a component of a contract. The boards are not aware of any practice issues that would justify a departure from the approach in ASC Subtopic 605-25. The boards have simplified and condensed the requirements in ASC Subtopic 605-25 because the proposed requirements would replace some of the specific revenue recognition requirements in US GAAP (for example, for software and construction-type contracts) that otherwise would need to be considered when assessing scope.

Exchanges of products to facilitate a sale to another party (paragraph 6(e))

- BC25 In industries with homogeneous products, it is common for entities in the same line of business to exchange products to facilitate sales to customers other than the parties to the exchange. An example is when an oil supplier swaps inventory with another oil supplier to reduce transport costs, meet immediate inventory needs or otherwise facilitate the sale of oil to the end customer. The boards noted that a party exchanging inventory with an entity would meet the boards' definition of a customer because it has contracted with the entity to obtain an output of the entity's ordinary activities. As a consequence, an entity might (in the absence of specific requirements) recognise revenue once for the exchange of inventory and then again for the sale of the inventory to the end customer. The boards concluded that outcome would be inappropriate because:
- (a) it would gross up revenues and expenses and make it difficult for users to assess the entity's performance and gross margins during the reporting period; and
 - (b) some view the counterparty in those arrangements as a supplier and not as a customer.

- BC26 The boards considered modifying the definition of a customer. However, they rejected that alternative because of concerns about unintended consequences. Therefore, the boards propose to exclude from the scope of the proposed requirements transactions involving non-monetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange.

Recognition of revenue (paragraphs 8–33)

Contract-based revenue recognition principle

- BC27 In the discussion paper, the boards proposed a principle to recognise revenue based on the accounting for the asset or liability arising from a contract with a customer. The boards concluded that focusing on the recognition and measurement of that asset or liability, and the changes in that asset or liability over the life of the contract, would bring discipline to the earnings process approach. Consequently, it would result in entities recognising revenue more consistently than when applying existing standards.
- BC28 On entering into a contract with a customer, an entity obtains rights to receive consideration from the customer and assumes obligations to transfer goods or services to the customer (performance obligations). The combination of those rights and performance obligations gives rise to an asset or liability depending on the relationship between the remaining rights and performance obligations. If the measure of the remaining rights exceeds the measure of the remaining performance obligations, the contract is an asset (a contract asset). Conversely, if the measure of the remaining performance obligations exceeds the measure of the remaining rights, the contract is a liability (a contract liability).
- BC29 By definition, revenue from a contract with a customer cannot be recognised until a contract exists. Revenue recognition could, in concept, arise at the point at which an entity enters into a contract with a customer. For an entity to recognise revenue at contract inception (ie before either party has performed), the measure of the entity's rights must exceed the measure of the entity's performance obligations. That would lead to revenue recognition because of an increase in a contract asset. However, as discussed in paragraphs BC76–BC78, the boards proposed in the discussion paper that performance obligations should be measured at the same amount as the rights in the contract, thereby precluding the recognition of a contract asset and revenue at contract inception.

- BC30 Hence, in the discussion paper, the boards proposed that revenue should be recognised only when an entity transfers a promised good or service to a customer, thereby satisfying a performance obligation in the contract. That transfer results in revenue recognition because on satisfying a performance obligation, an entity no longer has that obligation to provide the good or service. Consequently, its position in the contract increases—either its contract asset increases or its contract liability decreases—and that increase leads to revenue recognition.
- BC31 Although in concept revenue arises from an increase in a contract asset or a decrease in a contract liability, the boards have articulated the proposed requirements in terms of recognition and measurement of revenue rather than recognition and measurement of the contract. The boards thought that focusing on the timing and amount of revenue would simplify the articulation of the proposed requirements. Feedback from respondents to the discussion paper and others confirmed that view.
- BC32 Nearly all respondents to the discussion paper agreed with the boards' view that, in general, an entity should not recognise revenue in the absence of a contract with a customer. Once a contract exists, however, some respondents supported an activities model in which revenue would be recognised when the entity undertakes activities to fulfil a contract, regardless of whether those activities result in the transfer of goods or services to the customer (ie regardless of whether a performance obligation is satisfied). Those respondents reasoned that recognising revenue continuously throughout long-term construction or other service contracts, regardless of whether goods or services are transferred to the customer, would provide users of financial statements with more useful information.
- BC33 However, the boards noted the following concerns with an activities model:
- (a) Revenue recognition would not be based on accounting for the contract—in an activities model, revenue arises from increases in the entity's assets, such as inventory or work in progress, rather than from the contract. Therefore, conceptually, an activities model does not require a contract with a customer for revenue recognition, although revenue recognition could be deferred until a contract exists. However, that would result in revenue being recognised at contract inception for any activities completed to that point.
 - (b) It would be counter-intuitive to many users of financial statements—an entity would recognise consideration as revenue

when the customer has not received any promised goods or services in exchange.

- (c) There would be potential for abuse—an entity could accelerate revenue recognition by increasing its activities (for example, production of inventory) at the end of a reporting period.
- (d) It would result in a significant change to existing standards and practices—in many of those standards, revenue is recognised only when goods or services are transferred to the customer. For example, in IAS 18, revenue from the sale of a good is recognised when the entity has transferred the ownership of the good to the customer. The boards also observed that the principle of percentage of completion accounting in existing standards can also be consistent with the proposed revenue recognition principle in many cases. Paragraph 22 of AICPA Statement of Position 81-1 *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (ASC Subtopic 605-35) states that the basis for percentage of completion is that ‘the business activity taking place supports the concept that in an economic sense performance is, in effect, a continuous sale (transfer of ownership rights) that occurs as the work progresses’.

BC34 Accordingly, the boards did not develop an activities model and maintained their preliminary view that a contract-based revenue recognition principle would be the most appropriate principle for a general revenue recognition standard for contracts with customers.

Combination and segmentation of contracts (paragraphs 12–16)

BC35 The discussion paper assumed that an entity would apply the requirements of the proposed revenue recognition model to a single contract with a customer. That assumption is appropriate in most cases. However, in subsequent discussion, the boards observed that the pattern of revenue recognition from a contract might vary depending on whether an entity applies the proposed requirements to a contract on a stand-alone basis, to a contract together with other contracts, or to separate parts of a single contract.

BC36 The boards considered the requirements in existing standards (for example, IAS 11, IAS 18, ASC Subtopic 605-25 and ASC Subtopic 605-35) on combining contracts and concluded that the criteria and terminology reflect a consistent underlying principle for combining

contracts: namely, an entity should combine two or more contracts and account for them as a single contract if their prices are interdependent. The boards decided to provide indicators of when contracts have interdependent prices. Those indicators are similar to those in existing standards.

- BC37 The principle for combining contracts has an implication for segmenting a contract: an entity should segment a single contract with a customer and account for it as two or more contracts if the prices of some goods or services to be transferred to the customer are independent of the prices of other goods or services.
- BC38 During consultations following publication of the discussion paper, some preparers of financial statements questioned the need for a contract segmentation principle in addition to the requirements for identifying separate performance obligations in a contract (discussed in paragraphs BC45–BC59). The boards decided that a segmentation principle was needed:
- (a) to simplify the assessment of scope—if some goods or services in the contract are priced independently and are within the scope of other standards, the contract segmentation principle would require an entity to segment the contract and account for each of the resulting identified contracts in accordance with the relevant standard; and
 - (b) to determine the promised goods or services to which an entity should allocate proportions of the transaction price—if a contract has a variable transaction price, the proposals require an entity to allocate changes in the transaction price to all performance obligations in the contract. If the prices of some goods or services are independent, an entity would account for the goods or services (and the corresponding transaction price) as a separate contract. Hence, the entity would not allocate changes in the transaction price of one bundle of performance obligations identified as a contract to another bundle of performance obligations identified as another contract.

Contract modifications (paragraphs 17–19)

- BC39 When a contract is modified, an entity would be required to determine whether the modification amends the existing contract or creates an additional contract.

- BC40 The boards decided that the principle for combining and segmenting contracts should also determine how to account for a contract modification. That principle would ensure similar accounting for similar rights and obligations, regardless of the form of a contract. The boards also decided that a contract modification must meet the same criteria specified in paragraph 10 for determining whether a contract exists for the purposes of applying the proposed revenue recognition requirements. The boards concluded that it would be inappropriate for an entity to recognise revenue unless the entity has satisfied a performance obligation and a right to consideration exists (even if the measurement of the right is uncertain).
- BC41 If the price of a contract modification is interdependent with the price of the existing contract, the boards decided that the entity should, at the time of the modification, recognise the cumulative effects of that modification on the original contract. Otherwise, an entity might account for similar rights and obligations differently depending on how the contract was structured and whether the contract's terms and conditions were negotiated at contract inception or renegotiated during the life of the contract. The boards' decision on allocating the updated transaction price arising from a contract modification is consistent with their views on accounting for subsequent changes in transaction price as discussed in paragraph BC87.

Identifying separate performance obligations (paragraphs 20–24)

Definition of a performance obligation

- BC42 In the discussion paper, the boards distinguished obligations to provide goods or services to a customer from other obligations by describing them as performance obligations. Performance obligations are similar to the notions of deliverables, components or elements of a contract in existing standards. Although the notion of a performance obligation is implicit in many existing standards, the term *performance obligation* has not been defined and, hence, the boards proposed a definition in the discussion paper. Respondents generally agreed with the boards' proposed definition. Therefore, the boards have used that definition in the proposed requirements with minor modification.
- BC43 Some respondents to the discussion paper argued that some promises to provide goods or services, although meeting the definition of a performance obligation, should be accounted for as marketing expenses. Examples include 'free' handsets given by telecommunication entities as

an incentive for customers to enter into service contracts and customer loyalty points awarded by supermarkets, airlines and hotels. Those respondents reasoned that revenue should be recognised only for the main goods or services that the customer is seeking to acquire.

- BC44 The boards concluded that all goods or services provided to a customer as a result of a contract give rise to performance obligations in that contract because they are part of the negotiated exchange between the entity and its customer. Although the entity might characterise those goods or services as marketing incentives, they are goods or services provided in the contract for which the customer pays. In contrast, marketing incentives are incurred independently of the contract that they are designed to secure. The boards also noted that even if a conceptual justification could be found to distinguish goods or services that are marketing incentives from those that give rise to performance obligations, it would be difficult to develop criteria to make that distinction in practice.

Distinct goods or services

- BC45 Contracts with customers can contain many performance obligations. In the discussion paper, the boards proposed that an entity should refer to the timing of transfer of the promised goods or services to identify the performance obligations that should be accounted for separately. Although many respondents to the discussion paper agreed with that principle, some respondents were concerned that applying that principle would not be practical when goods or services are transferred continuously because an entity would need to estimate a stand-alone selling price for numerous goods or services. The boards agreed and decided to clarify how an entity should identify separate performance obligations.
- BC46 Respondents to the discussion paper and participants at the boards' workshops had mixed views on determining whether to account for a promise of a good or service as a separate performance obligation. Representatives from the construction industry preferred to account for all the promised goods or services in a contract as a single performance obligation unless a part of the contract is regularly sold separately. Otherwise, they thought that the proposed revenue recognition model would not be practical and would not provide useful information to users of financial statements who, they believe, are more interested in the total contract profit margin than in the revenue and profit margin of an individual good or service in the contract.

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- BC47 In contrast, representatives from other industries (for example, the technology industry) preferred to account for an individual good or service as a separate performance obligation even if it is not sold separately. Those representatives thought that to do otherwise would result in an entity's financial statements not providing users with useful information about revenue and profit margins as the entity transfers goods or services to customers.
- BC48 Consequently, when considering how entities across various industries should identify separate performance obligations, the boards' objective was to develop requirements that would result in an entity recognising revenue and profit margins in a manner that faithfully depicts the transfer of goods or services to the customer and that would be practical. To achieve that objective, the boards decided that an entity should account for a promise of a good or service as a separate performance obligation only if that good or service is distinct.
- BC49 The best evidence that a good or service is distinct is when the good or service is sold separately. If a good or service is not sold separately, the boards decided that an entity should account for the promised good or service as a separate performance obligation only if it could be sold separately. In the absence of additional guidance, it would be difficult and highly subjective to assess whether a good or service could be sold separately. Part of that difficulty stems from the fact that, in theory, almost anything could be sold separately. Hence, for the purposes of revenue recognition, the boards decided to provide additional guidance on whether an entity could sell a good or service separately and, therefore, should account for that promised good or service as a separate performance obligation. The boards decided to require a promised good or service to have a distinct function and a distinct profit margin.

Distinct function

- BC50 A good or service has a distinct function if it has utility either on its own or together with other goods or services. A good or service with utility on its own is an asset that, on its own, can be consumed, disposed of, held or otherwise used in a way that generates economic benefits. Even if a good or service does not have utility on its own, it nevertheless would be a distinct asset if it has utility together with other goods or services—either goods or services that the customer has acquired from the entity or goods or services that are sold separately by the entity or by another entity.

- BC51 If a good or service does not have a distinct function, it is questionable whether it is an asset. Hence, the boards thought that requiring a good or service to have a distinct function would emphasise that an entity can have a performance obligation only for contractual promises that, when fulfilled, result in the transfer of an asset to the customer.
- BC52 The boards noted that requiring a distinct function is consistent with the guidance on multiple-element arrangements in ASC Subtopic 605-25, which requires a delivered item to have 'value to the customer on a standalone basis' in order for an entity to account for that item separately. However, the boards decided against using that terminology because it could suggest that an entity must identify performance obligations on the basis of its assessment of the customer's intended use of the promised goods or services (which would affect the 'value to the customer'). It would be difficult, if not impossible, for an entity to know the customer's intentions in any given contract.

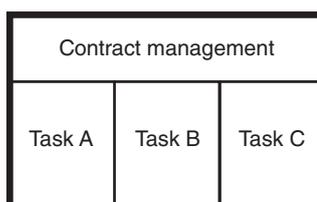
Distinct profit margin

- BC53 Even if a good or service has a distinct function, the boards decided that it should be accounted for as separate performance obligation only if it also has a distinct profit margin. If a good or service does not have a distinct profit margin, the boards were concerned that requiring an entity to estimate a selling price for that good or service might result in information that would not be useful to users of financial statements.
- BC54 The proposed requirement of a *distinct profit margin* is similar to the guidance on construction-type contracts in ASC Subtopic 605-35 that results in an entity accounting for elements of a contract separately only if each has a different rate of profitability.
- BC55 When a good or service is sold separately, the profit margin clearly is distinct and could be determined by subtracting the costs of the good or service from its stand-alone selling price. When a good or service is not sold separately, its selling price is not observable, which can make it more difficult for an entity to determine whether it has a distinct profit margin. In the absence of an observable selling price, the boards' view is that an entity would have sufficient basis for estimating a selling price only if the good or service is subject to distinct risks and the entity can separately identify the resources needed to provide the good or service. Otherwise, the entity typically would not sell a good or service separately—not because it lacks a distinct function, but because the entity would lack a basis for determining the price at which it would sell the good or service separately.

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BC56 In some contracts, a good or service would not have a distinct profit margin because it is not subject to distinct risks. For example, in some construction contracts, the contractor provides a significant contract management service in addition to providing, or subcontracting for, the individual construction tasks. That contract management service is provided because some of the individual construction tasks are highly interrelated, requiring the contractor to manage and co-ordinate the various tasks. Moreover, if the contractor employed subcontractors, the contract management service might also cover the risk that the tasks performed by the subcontractors are not in accordance with the contract specifications and do not combine with other services to provide the integrated construction services for which the customer contracted. The relationship between the contract management service and the individual construction tasks can be illustrated as follows:

Diagram 1 – Contract with one separate performance obligation



BC57 Diagram 1 above illustrates a contract consisting of three tasks that are sold separately (each could be performed by a subcontractor). However, Tasks A, B and C are highly related, thus requiring the entity to provide a significant contract management service to the customer that is associated with all of those tasks. Because the contract management service provided in conjunction with Tasks A, B and C is subject to the same risks as the underlying, related construction tasks, the contract management service does not have a distinct profit margin. Hence, the contractor would be required to combine that service with the tasks with inseparable risks (Tasks A, B and C) and account for all those promised goods or services as a single performance obligation.

BC58 In other contracts, the risks of the contract management service are either immaterial or they are attributable to specific tasks. In those contracts, the contract management service still would not have a distinct profit margin. However, the contractor would be able to combine a part of that service with a specific task. Hence, the entity would account for each task and part of the contract management service as a separate performance obligation. This is illustrated below in Diagram 2.

Diagram 2 – Contract with three separate performance obligations

Contract management	Contract management	Contract management
Task A	Task B	Task C

- BC59 The boards also decided that the resources required to provide a good or service must be distinguishable for an entity to account for the good or service as a separate performance obligation. If the resources needed to provide a good or service cannot be identified separately, the boards concluded that the profit margin of the good or service would not be distinct. Hence, the entity would not have a basis for estimating a selling price for that good or service and the entity should not account for that promised good or service as a separate performance obligation.

Satisfaction of performance obligations (paragraphs 25–33)

Control (paragraphs 25–31)

- BC60 Assessing the transfer of a good or service is critical to the proposed revenue recognition model because it determines when an entity satisfies a performance obligation and, hence, recognises revenue. Most existing revenue standards require an entity to assess the transfer of an asset by considering the risks and rewards of ownership of the asset. However, the boards decided that an entity should assess whether a transfer of an asset has occurred by considering whether the customer obtains control, for the following reasons:
- (a) The boards' existing definitions of an asset use control to determine when an entity should recognise or derecognise an asset. Because the proposed requirements can be viewed as an asset derecognition model, the boards decided to rely on the existing definitions of an asset.
 - (b) A focus on control rather than risks and rewards should result in more consistent decisions about when goods or services are transferred. It can be difficult for an entity to judge whether a preponderance (or some other balance) of the risks and rewards of ownership of a good or service has been transferred to the

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customer if the entity retains some risks and rewards. Consequently, a risks and rewards approach for determining the transfer of goods or services can result in different accounting for economically similar contracts.

- (c) A risks and rewards approach could conflict with identifying separate performance obligations. For example, if an entity transfers a product to a customer but retains some risks associated with that product, an assessment based on risks and rewards might result in the entity identifying a single performance obligation that could be satisfied only after the risks are eliminated. However, an assessment based on control might appropriately identify two performance obligations—one for the product and another for a remaining service such as a fixed-price maintenance agreement. Those performance obligations would be satisfied at different times.

BC61 Respondents to the discussion paper generally supported control as the basis for determining the transfer of goods or services. However, nearly all respondents asked the boards to clarify what control of a good or service is and how an entity would determine when control has transferred to the customer.

BC62 In the light of those responses, the boards have specified in the proposed requirements that control of a good or service refers to the ability to direct the use of, and receive the benefit from, a good or service. This definition is based on the meaning of control in the asset definitions in the boards' respective conceptual frameworks. In developing that definition, the boards decided that the definition of control (of a good or service) should include the following components:

- (a) *ability*—a customer must have the *present* right to direct the use of, and receive the benefit from, a good or service for an entity to recognise revenue. For example, in a contract that requires a manufacturer to produce an asset for a particular customer, it might be clear that the customer will ultimately have the right to direct the use of, and benefit from, the asset. However, the entity should not recognise revenue until the customer has obtained that right (which might occur during production or after, depending on the contract).
- (b) *to direct the use of*—a customer's ability to direct the use of a good or service refers to the customer's right to deploy that asset in its activities, to allow another entity to deploy that asset in its activities, or to restrict another entity from deploying that asset.

The source of that right in the context of revenue recognition typically is an enforceable right as a consequence of a contract.

- (c) *to receive the benefit from*—the customer must have the ability to receive the economic benefit from a good or service for the customer to obtain control of it. In concept, the economic benefit from a good or service is a potential cash flow (either an increase in cash inflows or a decrease in cash outflows). An entity can obtain the benefit directly or indirectly in many ways such as by using, consuming, disposing of, selling, exchanging, pledging or holding an asset.

- BC63 The definition of *control* could be applied from the perspective of either the entity selling the good or service or the customer purchasing that good or service. Consequently, revenue could be recognised when the entity surrenders control of a good or service or when the customer obtains control of that good or service. Although, in many cases, both perspectives are likely to lead to the same result, the boards have articulated the proposed indicators of control from the perspective of the customer. That perspective would minimise the risk of an entity recognising revenue from undertaking activities that do not coincide with the transfer of goods or services to the customer.
- BC64 Respondents to the discussion paper were most concerned about the application of the control guidance to contracts in the construction industry currently accounted for using a percentage of completion method of revenue recognition. Many respondents thought the proposals in the discussion paper could result in revenue recognition for construction contracts only upon transfer of legal title or physical possession of the finished asset, which often is upon contract completion. Because those contracts can take many years to complete, respondents thought that users of financial statements would be deprived of useful information unless revenue is recognised throughout the contract.
- BC65 The boards did not intend that revenue should be recognised only upon contract completion. Nonetheless, the intention was that an entity would recognise revenue only when the customer receives promised goods or services and not necessarily as the entity undertakes activities to fulfil the contract. In the case of a construction contract, the customer receives the promised goods or services during construction only if the customer controls the work in progress. In contrast, if the customer does not receive the goods or services until the work is completed, the entity would not recognise revenue until then.

- BC66 The boards think that applying the proposed definition of control and the proposed indicators of control to a construction contract would be consistent with the requirements currently contained in IFRIC 15 *Agreements for the Construction of Real Estate* for determining when a customer continuously obtains control of a promised asset.

Repurchase agreements (paragraphs B47–B53)

- BC67 When developing the proposed requirements on control, the boards considered how an entity would apply the proposed requirements to contracts in which an entity sells an asset and also enters into a repurchase agreement (either in the same contract or in another contract).
- BC68 If the entity has an unconditional obligation or right to repurchase an asset (ie a forward or call option), the boards concluded that the customer does not obtain control of the asset and, therefore, no revenue is recognised. That is because the customer is constrained in its ability to direct the use of, and receive the benefit from, the asset. Because the customer is obliged to return, or to stand ready to return, the asset to the entity, the customer cannot use up or consume the entire asset. Moreover, the customer cannot sell the asset to another party (unless that sale is subject to a repurchase agreement, in which case the customer's benefit from the sale is constrained).
- BC69 In theory, the customer is not constrained in its ability to direct the use of, and receive the benefit from, the asset if the entity agrees to repurchase, at the prevailing market price, an asset from the customer that is substantially the same and is readily available in the marketplace. However, the boards noted that an entity would be unlikely to enter into such a transaction.
- BC70 If the customer has an unconditional right to require the entity to repurchase an asset (ie a put option), the boards concluded that the customer does obtain control of the asset. That is because the customer is neither obliged to return the asset nor obliged to stand ready to do so. Therefore, the customer has the ability to direct the use of, and receive the benefit from, the asset—it can sell, use up or consume the entire asset and choose not to exercise the put option.

- BC71 If the customer has an unconditional right to require the entity to repurchase an asset, the boards concluded that the entity should account for its obligation to stand ready to repurchase the asset. That is consistent with the proposed accounting for the sale of a product with a right of return (see paragraphs BC187–BC194), which results in the entity recognising:
- (a) a liability for its obligation to repurchase the asset measured at the amount of the expected (probability-weighted) consideration to be paid to the customer; and
 - (b) an asset for the entity's right to receive the asset upon settling that liability.
- BC72 Some argue that, in some contracts, the terms of the put option and the surrounding facts and circumstances economically constrain the customer so that the customer neither directs the use of, nor receives the benefit from, the asset. Although the customer is not obliged to exercise its put option, the customer could incur a loss if it did not exercise its right. Hence, they reason that in such contracts the customer does not obtain control of the asset and that, economically, the transaction is similar to a forward contract. However, the boards noted that if a customer is virtually certain to exercise its put option and receive a full refund, accounting for the put consistently with a right of return would result in recognising assets and liabilities similar to those that would be recognised if the contract were accounted for as a forward contract. In addition, virtually no revenue would be recognised at the point of sale. Therefore, the boards concluded that it would be preferable to deal with the likelihood of the customer exercising a put option through the measurement of the consideration allocated to the performance obligation to transfer the asset and to the liability to repurchase the asset, rather than by developing criteria to specify when a put option should be accounted for similarly to a forward contract.

**Continuous transfer of goods or services
(paragraphs 32 and 33)**

- BC73 Some performance obligations, when satisfied, result in the transfer of a good or service to the customer at a point in time. Other performance obligations result in the transfer of goods or services to the customer continuously over a period of time. Examples of the latter include

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product maintenance services and construction services. To recognise revenue in those cases, an entity must determine the amount of performance obligations satisfied during each reporting period—ie the entity must measure its performance.

- BC74 The proposed requirements specify that an entity should select a revenue recognition method that best depicts the entity's performance under the contract. The definition of performance in the proposed model is not flexible—an entity performs only when it transfers goods or services to a customer. However, the proposed requirements for measuring performance cannot be too rigid if they are to be applied across various industries and transactions. In principle, the boards expect that methods based on outputs (for example, surveys of work performed) to the customer would provide the best depiction because they directly measure some attribute of the goods or services transferred to the customer. However, the boards acknowledged that output methods may not always be practical if, for instance, the output to the customer is not directly observable or if the output cannot be measured reliably in a cost-effective manner.
- BC75 The boards decided that an entity must select a method to measure performance for each separate performance obligation and must use that method consistently for that performance obligation and also across contracts that have performance obligations with similar characteristics. The boards do not want an entity to use different methods to measure its performance in satisfying the same or similar performance obligations because that could reduce the comparability of information for users of financial statements. Moreover, if an entity were to change how it measures performance throughout a contract, it would effectively bypass the requirements for segmenting a contract and identifying separate performance obligations.

Measurement of revenue (paragraphs 34–53)

- BC76 In the discussion paper, the boards proposed an allocated transaction price approach to measure performance obligations. Under that approach, an entity would allocate the transaction price to each performance obligation on the basis of the relative stand-alone selling price of the good or service underlying that performance obligation.
- BC77 The discussion paper also described an alternative approach whereby an entity would measure performance obligations directly at current exit price. The main reasons for rejecting that approach were:

- (a) The boards were concerned that an entity could recognise revenue before transferring goods or services to the customer. That could occur at contract inception if the measure of rights to consideration exceeds the measure of the remaining performance obligations. That would be a typical occurrence because entities often include in the transaction price amounts to recover their costs to obtain a contract.
 - (b) Any errors in identifying performance obligations or in measuring those performance obligations could affect revenue recognised at contract inception.
 - (c) A current exit price for the remaining performance obligations would typically not be observable and an estimated current exit price could be complex and costly to prepare and difficult to verify.
- BC78 Nearly all respondents to the discussion paper agreed with the boards' preference for the proposed allocated transaction price approach over the alternative current exit price approach.

Determining the transaction price (paragraphs 35–49)

- BC79 The proposed requirements specify that an entity should initially measure its rights and performance obligations at the transaction price—ie the amount of consideration that the entity receives, or expects to receive, from the customer. The discussion paper assumed that the customer promised to pay a fixed amount of cash consideration that did not need to be adjusted to reflect the customer's credit risk or the time value of money. Therefore, after publishing the discussion paper, the boards considered how an entity would determine the transaction price when the promised consideration is:
- (a) variable in amount (paragraphs BC80–BC95);
 - (b) uncertain to be collected because of the risk that the customer might not be able to pay (paragraphs BC96–BC101);
 - (c) paid at a time different from when the entity provides goods or services (paragraphs BC102–BC105); or
 - (d) in a form other than cash (paragraphs BC106 and BC107).

Variable consideration

BC80 The boards considered the following questions when developing the proposed requirements for contracts in which a customer promises consideration that is variable in amount:

- (a) how to define the transaction price (paragraphs BC81–BC83);
- (b) how to account for subsequent changes in the transaction price (paragraphs BC84–BC89); and
- (c) whether and how to constrain the transaction price (paragraphs BC90–BC95).

Definition of the transaction price

BC81 The boards decided to define the *transaction price* as the amount of consideration that an entity expects to receive from a customer in exchange for transferring goods or services. At contract inception, an entity's expectations reflect the full range of possible cash flow scenarios in the contract. Those expectations are the basis for the entity's negotiated price with the customer. In other words, an entity acting rationally would negotiate a contract price whereby, at contract inception, the consideration the entity expects to receive from the customer would reflect the expected costs to provide the goods or services to the customer plus the expected profit margin. A useful measure of a performance obligation reflects the entity's expected costs of providing the promised goods or services plus a margin. Therefore, the boards thought that a probability-weighted estimate of consideration would result in the most useful measure of the performance obligations in the contract.

BC82 The boards rejected the alternative of defining the transaction price as an amount that passes a specified threshold (for example, *certain*, *most likely* or *probable* consideration to be received from the customer). The boards thought that any specified threshold would be arbitrary and noted that contracts that pass that threshold would be accounted for differently from contracts that do not. That could result in different accounting for similar contracts, depending on how closely a contract passes or misses the specified threshold. Moreover, measuring the transaction price at an amount that passes a specified threshold may not necessarily be a useful measure of the entity's performance obligations.

BC83 Some respondents suggested that a probability-weighted estimate of the possible consideration amounts would not be appropriate if the entity is certain to receive one of only two possible consideration amounts. Those respondents indicated that a probability-weighted estimate would result in a transaction price that is not a possible outcome in accordance with the contract. However, the boards decided that a probability-weighted amount would provide more useful information because it appropriately reflects the conditions that are present at each reporting date. For example, consider an entity that has equal probabilities of receiving either CU60 or CU80 depending on whether the entity meets a specified performance condition. A transaction price of CU60 would not reflect the possibility of receiving additional consideration. Conversely, a transaction price of CU80 would not reflect the risk of receiving a lesser amount. Therefore, even though the probability-weighted amount of CU70 [(CU60 × 50 per cent) + (CU80 × 50 per cent)] does not reflect either of the possible consideration amounts, the boards think that it appropriately reflects the conditions at the reporting date.

Subsequent changes in the transaction price

BC84 After contract inception, an entity revises its expectations about the amount of consideration to be received as uncertainties are resolved or new information about remaining uncertainties becomes available. To depict conditions that exist at each reporting date (and changes in conditions during the reporting period), the boards decided that an entity should update its estimate of the transaction price throughout the contract. The boards believe that depicting current conditions would provide more useful information to users than retaining the initial estimates, especially for long-term contracts subject to significant changes in conditions during the life of the contract.

BC85 The boards considered whether, if the transaction price changes during a contract, an entity should:

- (a) recognise those changes in profit or loss when those changes occur;
or
- (b) allocate those changes to all performance obligations.

BC86 The boards rejected the alternative of recognising the entire amount of a change in the estimate of the transaction price in profit or loss when that change occurs. In the boards' view, that alternative could result in a pattern of revenue recognition that does not faithfully depict the pattern of the transfer of goods or services. Moreover, recognising revenue immediately (and entirely) for a change in the estimate of the transaction

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price would be prone to abuse in practice. The boards considered whether changes in the estimate of the transaction price could be presented as a gain or loss separately from revenue, thus preserving the pattern of revenue recognition. However, the boards rejected that alternative because the total amount of revenue recognised for the contract would not equal the amount of consideration received from the customer.

- BC87 Instead, the boards decided that an entity should allocate a change in the transaction price to all performance obligations in the contract because the cumulative revenue recognised would depict the revenue that the entity would have recognised if, at contract inception, it had the information that was available at the subsequent reporting date. Consequently, the transaction price that is allocated to performance obligations that have already been satisfied would be recognised as revenue immediately.
- BC88 Some respondents suggested that the entire change in the transaction price should be allocated only to some performance obligations (for example, only to the remaining performance obligations or only to those performance obligations to which the uncertainty primarily relates). The boards rejected that alternative because the goods or services in a single contract (as identified using the segmentation principle in paragraph 15) have interdependent prices. Allocating a change in the transaction price to only some performance obligations would be inconsistent with the requirement to allocate the transaction price at contract inception to all performance obligations on a relative selling price basis. The boards thought that allocating subsequent changes in the transaction price differently from the initial allocation would result in a lack of discipline on how an entity should identify separate performance obligations and allocate consideration to them.
- BC89 Updating the estimate of the transaction price after contract inception (and reallocating it to the performance obligations) differs from remeasuring the performance obligations as discussed in paragraphs BC130–BC148 because the entity is remeasuring the customer consideration (ie the inflows). The entity does not remeasure the expected costs to satisfy the remaining performance obligations (unless the performance obligations become onerous).

Constraining revenue recognition when consideration is variable

- BC90 The boards considered whether to constrain revenue recognition if the customer promises a variable amount of consideration. The boards decided to constrain the transaction price because revenue is an important measure to users of financial statements when valuing an entity and because a significant portion of errors in financial statements have related to the overstatement or premature recognition of revenue.
- BC91 The boards considered existing standards and practices and obtained feedback from various parties, including users of financial statements, to identify the situations in which estimating the transaction price would provide useful information to users of financial statements. That feedback suggested that a probability-weighted estimate of the consideration to be received would be useful only if the entity can identify the possible consideration amounts and reasonably estimate the probabilities of those amounts.
- BC92 For an entity to identify possible amounts and reasonably estimate their probabilities, the boards concluded that the entity would need experience (either its own or the experience of others) with similar types of contracts. Without that experience, the level of uncertainty in the estimate of the variable consideration would be too high for users to find useful the measurement of any revenue recognised on the basis of that estimate. In other words, a user might find it more useful if an entity recognises revenue only when the uncertainty is resolved.
- BC93 The boards decided that experience was necessary but not sufficient to estimate variable consideration reasonably. The entity's experience must also be relevant to the contract because the entity does not expect significant changes in circumstances (ie the circumstances surrounding the current contract are similar to those surrounding the similar contracts in the past). To help an entity assess whether its experience is relevant to the contract, the boards decided to specify factors that would reduce the relevance of that experience. Those conditions were derived in part from existing guidance in US GAAP on estimating sales returns.

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BC94 The boards considered and rejected the following alternatives:

Alternative	Reasons for rejection
<p>Require estimates of the transaction price, but limit cumulative revenue recognised so that it does not exceed amounts that are certain</p>	<ul style="list-style-type: none"> • It conflicts with the core principle of the proposed requirements because in some circumstances, an entity would not recognise revenue when a good or service is transferred to the customer. • It can result in the recognition of losses when the contract is profitable. If revenue is not recognised, an entity would recognise a loss unless the costs of providing the good or service are deferred. The boards think that the costs relating to a good or service already transferred to the customer would not give rise to a recognisable asset. • Although it would be consistent with the guidance on multiple-element arrangements in ASC Subtopic 605-25, it would be inconsistent with IFRSs and other guidance in US GAAP, such as ASC Subtopic 605-35.
<p>Require estimates of the transaction price for only some types of uncertainty (for example, uncertainty that is primarily controlled by the entity)</p>	<ul style="list-style-type: none"> • Uncertainty is rarely, if ever, controlled by just one party or attributable to one single factor. Hence, it would be difficult and subjective to distinguish the various types of uncertainty (for example, seller-controlled versus customer-controlled uncertainty). • Even if it were possible to distinguish the various types of uncertainty, some exceptions might still be necessary depending on the <i>amount</i> of uncertainty. For example, some might think that an entity should not estimate uncertain consideration that is primarily controlled by the customer. However, many are comfortable with estimates of customer-controlled uncertainty if the entity has extensive experience with those types of contracts (for example, commissions of an insurance agent). • The proposed requirements could become unnecessarily complex and would lack a clear principle for how to account for variable consideration.

BC95 Some think that the boards should retain the existing requirement in the guidance on multiple-element arrangements in ASC Subtopic 605-25 that limits the amount of consideration allocated to a satisfied performance obligation to the amount that is not contingent on the satisfaction of performance obligations in the future (or meeting other specified performance conditions). They reason that if an entity recognises revenue in such situations, the resulting contract asset does not meet the definition of an asset. However, the boards disagreed and think that the contract asset recognised in such situations does meet the definition of an asset. Although the entity may not have the present right to collect consideration from the customer, it clearly has a valuable contractual right as a result of satisfying performance obligations. If the entity were to transfer the remaining rights and performance obligations in the contract to a third party, it would expect to be compensated for its past performance. The boards therefore think that, in concept, uncertainty in the amount of consideration should be reflected in the measurement of the contract asset rather than through recognition.

Collectibility (paragraph 43)

BC96 The core principle of the proposed requirements is for an entity to recognise as revenue the amount of consideration the entity receives, or expects to receive, in exchange for transferring goods or services to the customer. Therefore, the boards considered how an entity should account for any uncertainty arising from the possibility that the customer may be unable to pay—ie uncertainty about the collectibility of the promised consideration.

BC97 An entity's assessment of collectibility could affect either or both of the following:

- (a) the recognition of revenue (ie whether an entity recognises revenue when a good or service is transferred);
- (b) the amount of revenue (ie how much revenue an entity recognises when a good or service is transferred).

BC98 Some existing standards address collectibility through recognition. For example, ASC Section 605-10-S99 (SEC SAB Topic 13 *Revenue Recognition*) states that revenue can be recognised only if 'collectibility is reasonably assured'. In IFRSs, IAS 18 specifies that revenue is recognised only when 'it is probable that the economic benefits associated with the transaction will flow to the entity'. However, the boards noted the following consequences of having collectibility as a recognition criterion, similar to criteria in some existing standards:

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- (a) The boards would need to specify a probability threshold (for example, *reasonably assured* or *probable*) that must be passed before revenue would be recognised. However defined, that threshold could be viewed as arbitrary. In addition, it would result in no revenue being recognised if the threshold is not passed, but potentially all of the revenue being recognised if it is passed.
 - (b) It would not be consistent with the core principle of the proposed requirements because if the probability threshold is not passed, no revenue would be recognised when a good or service is transferred to the customer.
 - (c) Even with a threshold, the boards would need to decide whether and, if so, how collectibility would affect the amount of revenue once the specified threshold is passed.
 - (d) It would not be consistent with the accounting for a receivable, which incorporates uncertainty of collectibility in the measurement of that financial asset.
- BC99 Accordingly, the boards propose that uncertainty about the entity's ability to pay the consideration should be reflected in the measurement of the transaction price and, therefore, in the amount of revenue recognised when an entity satisfies a performance obligation.
- BC100 Including the uncertainty of collectibility in the measurement of revenue means that the transaction price reflects the amount of consideration that the entity expects to receive. For many contracts, an entity would expect to collect the full amount of promised consideration because the effect of the customer's credit risk would be immaterial. For those contracts, recognising the full amount as revenue would be consistent with IAS 39 *Financial Instruments: Recognition and Measurement*, which acknowledges that short-term receivables with no stated interest rate may be measured at the invoiced amount if the effect of discounting is immaterial. However, if the effect of the customer's credit risk is material, the transaction price would be the probability-weighted amount of consideration that the entity expects to receive. If the effect of the time value of money was also material to a contract, the adjustment for collectibility would be made through the discount rate (see paragraphs BC102–BC105).
- BC101 After the entity has obtained an unconditional right to consideration, the customer's credit standing could deteriorate or, alternatively, it could improve. If the entity has recognised revenue, the effects of the resulting reassessments of credit risk could be recognised in the period of change

as an adjustment to the revenue recognised or as an expense or income that is recognised separately from revenue. The boards decided that the latter approach was most consistent with the proposed requirements, which focus on the exchange between the entity and its customer. In effect, once the entity has satisfied the performance obligation, it has received an asset in exchange—a promise of payment. Hence, any reassessment of the customer's credit standing should be recognised as an impairment (or reversal of impairment) of the receivable rather than a change to the amount of revenue previously recognised. The boards noted that this accounting would be similar to the accounting for non-cash consideration received in exchange for a good or service—for example, an equity stake in another entity—if the value of that asset subsequently decreased. The revenue recognised would reflect the value of the equity stake at the date the good or service was transferred—ie the value of the asset the entity received in exchange for providing the good or service—and any subsequent change in the value of that equity stake would not affect revenue.

The time value of money (paragraphs 44 and 45)

- BC102 Some contracts contain a financing component (either explicitly or implicitly) because performance by an entity (ie satisfaction of a performance obligation) and payment by its customer occur at significantly different times.
- BC103 The boards propose that the amount of promised consideration from the customer should be adjusted to reflect the time value of money if the contract includes a material financing component. In other words, the amount of the transaction price that is allocated to the performance obligations should be the nominal amount of the consideration, adjusted for the financing component. Hence, when a performance obligation is satisfied, the amount of revenue recognised is the amount of the transaction price adjusted for the financing—in effect, the 'cash sales price' of the underlying good or service. Interest income or expense is recognised on the contract asset or contract liability. In support of this approach, the boards observed that:
- (a) Entities are not indifferent to the timing of the cash flows in a contract. Therefore, reflecting the time value of money portrays an important economic feature of the contract. A contract in which the customer pays for a good or service when that good or service is transferred to the customer is different from a contract in which the customer pays significantly before or after the good or service is transferred. Even if an entity charges its customer the same

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nominal amount in both cases, it has, in fact, charged different amounts in each case once the financing has been taken into account. Hence, to be useful to users, the accounting should reflect those differences.

- (b) Not recognising the financing component could misrepresent the profit of a contract. For example, if the financing component is ignored and a customer pays in advance, the entity would recognise income (in the form of interest earned on the cash received) from the contract before it transfers any good or service to the customer. In effect, this front-ends the recognition of profit from the contract. That is because, rationally, that interest was received as compensation for accepting a lower nominal price for the good or service. Similarly, if a customer pays in arrears, ignoring the finance component of the contract would result in full profit recognition on the transfer of the good or service, despite the ongoing cost to the entity of providing financing to the customer.
- (c) Contracts with explicitly identified financing components would be accounted for consistently with contracts in which the financing component is implicit in the contract price.

BC104 The boards considered whether the rate used to reflect the financing should be the risk-free rate. That rate would be observable and simple to apply, and it would avoid the costs of determining a rate specific to each contract. However, the boards concluded that using the risk-free rate would not result in useful information because the resulting interest would not reflect the characteristics of the parties to the contract. In addition, the boards noted that it would not necessarily be appropriate to use any rate explicitly specified in the contract because the entity might offer 'cheap' financing as a marketing incentive and, hence, using that rate would not result in an appropriate recognition of profit over the life of the contract. Therefore, the boards propose that an entity should use the rate that would be used in a financing transaction between the entity and its customer that did not involve the provision of goods or services because that rate would reflect the characteristics of the parties to the contract. However, because that rate also would reflect the customer's creditworthiness, the boards have specified that an entity should not also adjust the amount of the promised consideration for collectibility.

BC105 Some existing standards require an entity to recognise the effects of financing only if the time period exceeds a specified period, often one year. For example, ASC paragraph 835-30-15-3 excludes those ‘... transactions with customers or suppliers in the normal course of business that are due in customary trade terms not exceeding approximately one year’. The boards decided against that approach and instead decided to require management to use its judgement to assess whether the effects of the time value of money are material to the contract. The boards observed that the time value of money could be material for short-term contracts with high implicit interest rates and, conversely, may be immaterial for long-term contracts with low implicit interest rates.

Non-cash consideration (paragraphs 46 and 47)

BC106 When an entity receives cash from a customer upon delivery of a good or service, the transaction price and, hence, the amount of revenue is the amount of cash received—ie the value of the inbound asset. To be consistent with that approach when the customer pays non-cash consideration (for example, goods or services), the boards decided that the entity also should measure non-cash consideration (or promises of non-cash consideration) at fair value.

BC107 If an entity cannot estimate the fair value of the non-cash consideration reliably, the boards decided that it should measure the promised consideration indirectly by reference to the selling price of the goods or services promised in exchange for the consideration. That approach is consistent both with requirements in some existing revenue standards (for example, IAS 18) and with requirements for other situations in which the fair value of the assets surrendered in exchange for assets received may be estimated more reliably (for instance, both IFRS 2 *Share-based Payment* and ASC Topic 718 on stock compensation state that if the fair value of the goods or services received cannot be estimated reliably, then the entity measures them indirectly by reference to the fair value of the granted equity instrument).

Consideration payable to the customer (paragraphs 48 and 49)

BC108 In some cases, an entity pays consideration to one of its customers or to other parties that purchase the entity’s goods or services from its customers (for example, an entity may sell a product to a dealer or distributor and subsequently make a payment to a customer of that

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dealer or distributor). That consideration might be a payment in exchange for goods or services received from the customer, a discount or refund for goods or services provided to the customer, or a combination of both.

- BC109 To help an entity distinguish among those types of payments, the boards decided that an entity should account for any good or service received in the same way as for other purchases from suppliers only if the good or service is distinct, using the same criteria proposed to identify a separate performance obligation. Existing requirements in US GAAP (ASC Section 605-50-45) on vendor's consideration given to a customer use the term *identifiable benefit*, which is described as a good or service that is 'sufficiently separable from the recipient's purchase of the vendor's products such that the vendor could have entered into an exchange transaction with a party other than a purchaser of its products or services in order to receive that benefit'. The boards think that notion is similar to the principle in the proposed requirements for assessing whether a good or service is distinct.
- BC110 The amount of consideration received from the customer for goods or services and any payment of consideration to that customer for goods or services could be linked. For instance, a customer may pay more for goods or services from the entity than it would otherwise have done if it was not receiving a payment from the entity. Therefore, to depict revenue faithfully in such cases, the boards concluded that any amount accounted for as a payment to the customer for goods or services received should be limited to the fair value of those goods or services, with any amount in excess of the fair value recognised as a reduction to the transaction price.
- BC111 If the payment of consideration is accounted for as a reduction of the transaction price, the entity would recognise less revenue when it satisfies the related performance obligation(s). However, in some cases an entity promises to pay consideration to a customer only after the entity has satisfied the performance obligation and, hence, after it has recognised revenue. Accordingly, the boards have specified that the reduction to revenue is recognised at the later of when the entity transfers the goods or services to the customer or the entity promises to pay the consideration. By using the phrase *promises to pay*, the boards intend to clarify that an entity should reflect in the transaction price payments to customers that are conditional on future events (for example, a payment to a customer conditional on the customer making a specified number of purchases).

Allocating the transaction price to separate performance obligations (paragraphs 50–53)

- BC112 In the discussion paper, the boards proposed that an entity should measure performance obligations in a contract by allocating the transaction price to those obligations. That allocation would determine the amount of revenue that an entity recognises as it satisfies each performance obligation and the measurement of the remaining performance obligations at each reporting date. The boards considered, but rejected, an alternative measurement approach, which would have been to measure the performance obligations directly at each reporting date. The boards concluded that this alternative would make accounting for the contract more complex. In addition, the boards expected that it would provide little additional information to users of financial statements in many cases, either because the values of goods or services promised are not inherently volatile or because the effect of any volatility that might exist is limited because an entity transfers the goods or services to the customer over a relatively short time.
- BC113 The discussion paper noted that the transaction price could be allocated using various bases, such as the stand-alone selling price of the promised goods or services or the expected cost of the promised goods or services, as estimated by the entity at contract inception. The boards proposed that an entity should allocate the transaction price in proportion to the stand-alone selling prices of the promised goods or services. They noted that an allocation based on stand-alone selling prices faithfully depicts the different margins that may apply to promised goods or services. In contrast, allocating the transaction price on the basis of the expected costs to provide the goods or services would be expected to result in a contract-wide margin being applied to all performance obligations in the contract.
- BC114 Most respondents agreed with the boards' proposals in the discussion paper, although some suggested that the boards should consider whether:
- (a) to constrain the use of estimates and specify a hierarchy for the basis of allocation (paragraphs BC115–BC121);
 - (b) to use the residual method as a basis for allocation (paragraphs BC122–BC125); or
 - (c) to change the basis for allocating a discount within a contract (paragraphs BC126–BC129).

Use of estimates

- BC115 Some respondents were concerned that recognising revenue on the basis of estimated stand-alone selling prices of goods or services could result in arbitrary accounting, reduce comparability in financial reporting and enable management to manipulate those estimates to accelerate or defer revenue. Expressing similar concerns, other respondents suggested that the boards should prescribe a measurement hierarchy similar to that in ASC Subtopic 605-25 to provide greater discipline in estimating stand-alone selling prices. That hierarchy requires an entity to determine a stand-alone selling price using vendor-specific objective evidence (VSOE) of selling price, if it exists. Otherwise, an entity would use third-party evidence (TPE) of selling price, if it exists, or the best estimate of the selling price if neither VSOE nor TPE exists.
- BC116 The boards confirmed that stand-alone selling prices would sometimes need to be estimated in order to achieve the objective of recognising revenue when goods or services are transferred to the customer. An alternative approach of allocating consideration only to those performance obligations for which the entity has directly observable prices would not always meet that objective.
- BC117 Compared with the proposals in the discussion paper, there would be fewer instances under the proposed requirements in which the transaction price would be allocated using estimates of stand-alone selling prices. That is because under the proposed requirements, entities allocate the transaction price only to separate performance obligations for distinct goods or services rather than potentially to every performance obligation in the contract. As specified in paragraph 23, separate performance obligations are identified only for promises to transfer goods or services that either:
- (a) are sold separately—in which case there would be observable prices for goods or services that are identical or similar to the promised goods or services; or
 - (b) have a distinct function and a distinct profit margin—in which case an entity should have sufficient information to reasonably estimate a stand-alone selling price for the promised good or service.
- BC118 For this reason, the boards think that the proposed requirements should ease concerns expressed by respondents to the discussion paper relating to:

- (a) using estimates of stand-alone selling prices to allocate the transaction price; and
- (b) the practical difficulties with developing those estimates for individual performance obligations.

BC119 Furthermore, practice under US GAAP is becoming accustomed to a greater use of estimates in recognising revenue. That is because ASU 2009-13 amended ASC Subtopic 605-25 on recognising revenue in multiple-element arrangements to require an entity to estimate the stand-alone selling price of a good or service if neither VSOE nor TPE of a stand-alone selling price is available.

BC120 The boards reaffirmed the view they expressed in the discussion paper that they will not preclude or prescribe any particular method for estimating a stand-alone selling price so long as the method:

- (a) is consistent with the basis of a stand-alone selling price (ie the price at which the entity would sell the distinct good or service if it were sold separately to the customer); and
- (b) maximises the use of observable inputs.

BC121 The boards decided against specifying a hierarchy of acceptable estimation methods. The boards observed that even if there is third-party evidence of a selling price, that price might require adjustments to reflect differences either in (a) the good or service (because the third-party price could be for a similar, rather than identical, good or service) or (b) pricing strategies between the third party and the entity. Hence, there is little distinction between TPE and best estimate in the hierarchy in ASC Subtopic 605-25. The boards concluded that it was important to emphasise that when using estimates, an entity should maximise the use of observable inputs.

Residual method

BC122 The residual method is an alternative way to allocate consideration in a multiple-element arrangement in the absence of an observable selling price (such as VSOE or TPE) for delivered items. With the residual method, remaining performance obligations in a contract are measured directly using objective and reliable evidence of the selling prices of the underlying goods or services. Any difference between that amount and the total transaction price is recognised as revenue for the satisfied performance obligations.

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- BC123 Some respondents to the discussion paper suggested that the proposed requirements should permit the residual method because it provides a less complex and, hence, less costly alternative to allocating the transaction price to separate performance obligations on a relative selling price basis.
- BC124 However, the boards noted that the residual method is unnecessary if an entity is required to estimate stand-alone selling prices. The boards noted that ASU 2009-13 amended ASC Subtopic 605-25 to preclude the use of the residual method as a consequence of the Emerging Issues Task Force's (EITF) decision to require entities to use estimated stand-alone selling prices for goods or services for which there is no VSOE or TPE.
- BC125 Consequently, the boards confirmed their view that the residual method should not be used to allocate the transaction price to separate performance obligations. However, the boards noted that a residual (or reverse residual) technique may be an appropriate method for estimating a stand-alone selling price if there is a directly observable price for one performance obligation but not the other.

The allocation of a discount within a contract

- BC126 A consequence of allocating the transaction price to each performance obligation in proportion to the stand-alone selling prices of the underlying goods or services is that any discount in the contract is allocated to all performance obligations. A few respondents to the discussion paper were concerned with this outcome and suggested that the allocation should be based on either:
- (a) management's assessment of which goods or services are transferred to the customer at a discount to their stand-alone selling price; or
 - (b) the prices stated in the contract.
- BC127 The boards were not persuaded to provide an exception to the proposed requirement of allocating the transaction price on the basis of stand-alone selling prices. The boards' view is that the transaction price is for the contract as a whole. Therefore, any discount in the contract is attributable to the contract as a whole and should be allocated proportionally to the separate performance obligations in the contract.

- BC128 The boards disagreed with the suggestion that management should choose the performance obligations to which the discount is allocated because that would reduce the discipline of the process of allocating the transaction price. However, if an entity has evidence that a discount relates only to some goods or services in a contract, the contract may meet the criteria in paragraph 15 for segmentation of the contract.
- BC129 The boards also disagreed with the suggestion that the allocation of the transaction price should be based on the prices stated in the contract. In the boards' view, a contractually stated price for a good or service in a contract cannot be presumed to represent the selling price for those goods or services. Consequently, the boards decided that a stand-alone selling price would need to be determined for a good or service even if the stated contract price for that good or service is zero.

Onerous performance obligations (paragraphs 54–56)

- BC130 The proposed requirements specify that an entity initially measures the separate performance obligations in a contract by allocating the transaction price to the performance obligations. Hence, as the entity satisfies each performance obligation, the reduction in the total amount of the entity's remaining performance obligations reflects the entity's transfer of goods or services to the customer.
- BC131 In the discussion paper, the boards noted that the amount of an entity's performance obligations could change for reasons other than an entity's performance (for example, for changes in the price or quantity of goods or services that an entity expects to transfer to the customer to satisfy its remaining performance obligations). The boards also noted that reflecting those changes in the measurement of the performance obligations would require an entity to remeasure its performance obligations at each reporting date. In the discussion paper, the boards rejected such an approach because they concluded that it would be unnecessarily complex for most contracts with customers.
- BC132 The boards observed that for most contracts with customers, the most significant change in an entity's performance obligations arises from the transfer of goods or services to the customer. Changes for other reasons are typically not significant. However, the boards acknowledged that sometimes those changes can be significant to the depiction of an entity's obligation to provide goods or services and that in such cases an entity would need to update the initial measurement of the performance obligations (ie remeasure them) for reasons other than an entity's

transfer of goods or services to the customer. Accordingly, in the discussion paper the boards proposed that an entity should remeasure a performance obligation and recognise a contract loss if the performance obligation is onerous (ie the entity's expected costs to satisfy the performance obligation exceed its carrying amount).

BC133 Most respondents agreed with the proposed approach of remeasuring performance obligations by exception only when they are onerous. Most agreed with the boards that remeasuring performance obligations over the life of the contract would be unnecessarily complex and also noted that such an approach would represent a significant change to current practice. A few respondents stated that performance obligations should never be remeasured and that losses on a contract should emerge over time as the revenue is recognised. However, the boards disagreed with that view, noting that:

- (a) both IFRSs and US GAAP include an onerous test for loss-making contracts (ie the amount allocated to the performance obligations must at least equal the expected costs to satisfy the performance obligations). Not having such a test would be a major change to current practice.
- (b) the onerous test can be viewed as the mirror image for liabilities of an asset impairment test (ie a test to ensure that the carrying amount of a performance obligation is not understated).

BC134 Therefore, the boards concluded that an onerous test is a necessary component of a revenue recognition model in which the initial measurements of performance obligations are not routinely updated. Moreover, including the onerous test in the proposed requirements would achieve greater convergence of IFRSs and US GAAP on the margins reported from contracts with customers.

Components of the onerous test

BC135 In developing the onerous test for contracts with customers, the boards considered:

- (a) the unit of account for applying the onerous test (paragraphs BC136 and BC137);
- (b) when a performance obligation should be deemed onerous (paragraphs BC138 and BC139);
- (c) the measurement basis for the onerous test (paragraphs BC140 and BC141).

- BC136 The unit of account for applying an onerous test could be at the level of either the remaining performance obligations in the contract or each separate performance obligation. If an onerous test is applied at the contract level, a contract loss would be recognised only if the remaining performance obligations considered together are loss-making. In contrast, if the onerous test is applied to separate performance obligations, an entity would recognise adverse changes in circumstances affecting a separate performance obligation as soon as they result in that separate performance obligation being loss-making. They are not offset against the margin in other parts of the contract.
- BC137 The boards decided to apply the onerous test to each separate performance obligation to maintain consistency with the model's objective to reveal different margins on different parts of the contract. Those different margins are revealed by identifying separate performance obligations and consequently the same unit of account should apply to test whether those separate performance obligations are onerous. A consequence of this approach is that an entity might need to recognise a contract loss for a separate performance obligation even though the contract as a whole remains profitable. However, the boards concluded that this would be preferable to applying the onerous test at the level of the whole contract because this could delay reporting adverse changes in circumstances.
- BC138 In the discussion paper, the boards considered two approaches to determining whether a performance obligation is onerous:
- (a) when the *expected costs* to satisfy the performance obligation exceed the amount of the transaction price allocated to it (cost trigger);
 - (b) when the *current price* of the performance obligation (ie the expected costs plus a margin) exceeds the amount of the transaction price allocated to it (current price trigger).
- BC139 The boards noted that the main consequence of using a cost trigger is that any margin in the measurement of the performance obligation would act as a buffer to absorb adverse changes in the performance obligation. In other words, the amount of the performance obligation would remain unchanged until the entity expects that the satisfaction of that performance obligation would result in a loss. In contrast, a current price trigger would not result in the margin acting as a buffer to absorb adverse changes in circumstances, thereby potentially resulting in earlier recognition of the effects of adverse changes in circumstances. The boards rejected the current price trigger because, as well as increasing the frequency of remeasurements, it would more closely

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resemble an approach in which the performance obligations are remeasured at each reporting date, an approach that the boards had rejected (as discussed in paragraph BC131). Almost all respondents agreed with the boards.

- BC140 The boards concluded in the discussion paper that once a performance obligation is onerous, it should be remeasured on a basis that is consistent with the trigger. Accordingly, they decided that an onerous performance obligation should be measured at the expected cost of satisfying the performance obligation. The boards discussed whether a margin should be included in the remeasurement of a performance obligation. The rationale for including a margin is that a profit-oriented entity typically does not promise to transfer a good or service to a customer without a margin. However, the boards noted that including a margin in the remeasurement would be a significant change to the requirements for loss-making contracts in existing standards (for example, IAS 11 and ASC Subtopic 605-35) and would increase the complexity of measuring performance obligations, particularly when observable prices do not exist. Furthermore, some think that it would be counter-intuitive for an entity to recognise a profit when it satisfies an onerous performance obligation.
- BC141 Almost all respondents agreed with the boards. However, the discussion paper did not specify which costs should be included in the onerous test and in the remeasurement of an onerous performance obligation. Therefore, in developing the proposed requirements, the boards considered which costs should be included. The boards decided that, consistently with the proposed requirements on accounting for fulfilment costs (discussed in paragraphs BC149–BC155), costs for the onerous test should be restricted to those that relate directly to a contract. In the absence of specifying a value or a price for the remeasurement, the boards concluded that this approach would provide a clear objective for which costs should be included. The boards also clarified that the expected costs to satisfy the remaining performance obligations should reflect all possible outcomes (ie the amount should be a probability-weighted measure of costs) to be consistent with how an entity would determine the transaction price.

Presentation of the liability for onerous performance obligations

- BC142 The discussion paper proposed that when an entity remeasures an onerous performance obligation, it should recognise the corresponding amount in profit or loss separately from revenue. The discussion paper was less clear on how the effects of the remeasurement would be reflected in profit or loss when the remeasured performance obligation is satisfied. Although the boards explained that the amount of revenue recognised for the entire contract is the amount of the transaction price, some respondents were concerned that the remeasured amount of the performance obligation would be recognised as revenue, not the amount initially allocated to the performance obligation.
- BC143 Because the remeasurement would need to be tracked separately for the purposes of reporting its effects in profit or loss separately from revenue, the boards concluded that it would be clearer if they specified that the remeasurement is recognised as a liability separate from the contract asset or contract liability. That would be consistent with existing standards and practice and would clarify that the remeasurement and its subsequent accounting should not affect revenue.

Rejection of an alternative measurement approach for some performance obligations

- BC144 The discussion paper highlighted that the proposed measurement approach might not result in useful information for some contracts, particularly for those with highly variable outcomes. Such contracts include those in which:
- (a) uncertainty is a significant inherent characteristic of the contract;
 - (b) the prices of the underlying goods or services are volatile; or
 - (c) the duration of the contract is such that significant changes in circumstances are likely.
- BC145 Therefore, the boards sought views from respondents on whether it would be more useful to measure some performance obligations on another basis.

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- BC146 Most respondents from the insurance industry stated that insurance performance obligations should be remeasured at each reporting date (ie they should be subject to another measurement approach) rather than being remeasured by exception only when they are onerous. A few other respondents suggested that some or all of the following performance obligations should be remeasured at each reporting date:
- (a) warranties and similar maintenance contracts;
 - (b) other stand-ready and conditional performance obligations; and
 - (c) long-term and large service contracts for which relatively small changes in circumstances can have significant effects.
- BC147 A few respondents had concerns similar to those of the respondents from the insurance industry. However, those respondents thought that the concerns did not justify the use of a different measurement approach for some performance obligations. Those respondents concluded that all performance obligations within the scope of the revenue recognition standard should be subject to the same measurement approach.
- BC148 In the light of the feedback received, the boards concluded that all performance obligations within the scope of the proposed requirements should be subject to the same measurement approach. The boards noted that many of the concerns raised by respondents, in particular those raised by insurers, would be addressed by the scope of the proposed requirements. In addition, the boards noted that:
- (a) most warranties within the scope of the proposed requirements would be of short duration. Moreover, even if the warranties were included within the scope of the standard on insurance contracts, it is possible that many would be accounted for using a simplified measurement model that is similar to the allocated measurement approach in the proposed requirements.
 - (b) the most common type of stand-ready obligation other than a warranty is a guarantee contract. Those obligations typically meet the definition of a financial instrument or an insurance contract and therefore would not be within the scope of the proposed requirements.
 - (c) the remaining types of stand-ready obligations and long-term and large service contracts are currently measured using an allocated transaction price approach, rather than using a direct measurement approach (for example, current exit price).

Contract costs (paragraphs 57–63)

Costs of fulfilling a contract

- BC149 In the discussion paper, the boards explained that they did not intend to include specific requirements on cost recognition in a revenue standard. Consequently, the boards proposed that costs would be recognised as expenses when incurred unless they would be eligible for capitalisation in accordance with other standards (for example, standards on inventory; property, plant and equipment; and capitalised software).
- BC150 Many respondents to the discussion paper were concerned about the boards' focus on revenue without considering the accounting for costs associated with contracts with customers. Some respondents, in particular those from the construction industry, said that guidance on profit margin recognition is as important as guidance on revenue recognition. Other respondents, mainly preparers using US GAAP, were concerned about the withdrawal of cost guidance that was developed specifically for their respective industries. Respondents asked the boards to reconsider the accounting for costs associated with contracts with customers.
- BC151 In reconsidering the accounting for those costs, the boards observed that existing standards would apply to some fulfilment costs (for example, costs incurred in creating inventory or acquiring property, plant and equipment). However, for other fulfilment costs (for example, contract set-up costs), the boards acknowledged the lack of clear guidance.
- BC152 In the absence of clear guidance, an entity applying US GAAP might analogue to the guidance on the deferral of direct loan origination costs in ASC paragraph 310-20-25-2. The FASB was concerned about an entity relying on that analogy because those requirements were developed for financial instruments rather than for goods or services in contracts with customers. An entity applying IFRSs would be required to evaluate costs in accordance with IAS 38 *Intangible Assets*, which was not developed for the specific context of contracts with customers. In addition, the boards were concerned that there would be no guidance replacing the existing guidance on pre-contract costs for construction contracts.
- BC153 Because of those concerns, the boards decided to develop common requirements for when an entity should recognise an asset that arises when an entity engages in activities that are necessary to enable it to satisfy a performance obligation. In developing those requirements, the

boards' intention is not simply to normalise profit margins throughout a contract by allocating revenue and costs evenly over the life of the contract. Rather, the intention is to focus on the recognition of assets associated with contracts with customers.

- BC154 To provide a clear objective for recognising and measuring any asset arising from contract fulfilment costs, the boards concluded that only costs that relate directly to a contract should be included in the cost of the asset.
- BC155 The boards considered testing for impairment any recognised asset arising from fulfilment costs using one of the existing impairment tests in their respective standards (for example, IAS 2 *Inventories* or inventory in ASC Section 330-10-35; IAS 36 *Impairment of Assets* or long-lived assets in ASC Section 360-10-35). However, the boards concluded that to be consistent with the measurement approach of the proposed requirements, the impairment test should be based on comparing the carrying amount of the asset with the remaining amount of consideration from the customer—ie the amount of the transaction price allocated to the remaining performance obligations. That also would be consistent with the test for identifying whether performance obligations are onerous (as discussed in paragraphs BC130–BC143).

Costs of obtaining a contract

- BC156 The boards' decision to address the costs of fulfilling a contract does not affect the boards' decision that an entity should recognise the selling, marketing, advertising and other costs of obtaining a contract as expenses when the entity incurs those costs. The costs of fulfilling a contract relate to assets separate from the contract (for example, inventory; property, plant and equipment; and intangible assets), although some of those costs may be incurred as part of the process of obtaining a contract (for example, engineering and design costs). However, the asset resulting from the costs of obtaining a contract is primarily the contract asset (unless those costs also relate to assets separate from the contract).
- BC157 As explained in paragraph BC28, a contract asset is the asset arising from the combination of the remaining rights and performance obligations in a contract. In concept, a contract asset can arise as a result of obtaining a contract if the measure of the remaining rights exceeds the measure of the remaining obligations. If a contract asset is recognised as a result of obtaining a contract, its measure at contract inception generally would depend on the amount the entity is able to include in the pricing of the

contract for the level of effort and resources required to obtain that type of contract. Hence, the value of the asset at contract inception would be greater in industries in which obtaining a contract with a customer is costly.

- BC158 Consistently with their reasons for rejecting the measurement of performance obligations at exit price (as noted in paragraph BC77), the boards concluded that an entity should recognise a contract asset and revenue only as a result of satisfying a performance obligation in the contract. Therefore, the proposed requirements specify that the contract asset is measured at nil at contract inception. Consequently, any costs of obtaining a contract are recognised as expenses when incurred, even if those costs are direct and incremental (for example, incremental costs of securing an investment management contract). That is different from some current practice, in which specified costs of obtaining a contract are recognised as an asset and amortised as the related revenue is recognised.

Presentation (paragraphs 64–68)

- BC159 The boards considered whether to require a gross presentation or a net presentation of the rights and performance obligations in a contract with a customer.
- BC160 In the discussion paper, the boards proposed that the remaining rights and performance obligations in a contract would form a single unit of account and would be accounted for, and presented, on a net basis as either a contract asset or a contract liability. The boards noted that the rights and obligations in a contract with a customer are interdependent—the right to receive consideration from a customer is dependent on the entity’s performance and, similarly, the entity will perform only as long as the customer continues to pay. They concluded that these interdependencies are best reflected by presenting the remaining rights and obligations net in the statement of financial position.
- BC161 Most respondents to the discussion paper agreed with a net presentation. Subsequently, in developing the proposed requirements, the boards considered whether the rights and performance obligations in any contracts should be presented on a gross basis, ie as separate assets and liabilities. In particular, the boards considered contracts that are subject to the legal remedy of specific performance. The boards observed that in the event of a breach, such contracts require the entity and the customer to perform as specified in the contract. Therefore, unlike most contracts that can be settled net, specific performance contracts generally would

result in a two-way flow of resources between the customer and the entity. The contracts are akin to those financial contracts that are settled by physical delivery rather than by a net cash payment and for which the units of account are the individual assets and liabilities arising from the contractual rights and obligations.

- BC162 The boards decided against making any exception for specific performance contracts. That is because the remedy of specific performance is relatively rare and is not available in all jurisdictions. In addition, it is only one of a number of possible remedies that could be awarded by a court if legal action were taken for breach of contract. Therefore, basing the accounting on a determination of what would happen in that event would both be counter-intuitive (because entities do not enter into contracts with the expectation that they will be breached) and difficult (because an entity would need to determine at contract inception what remedy would be awarded by the court if litigation were to take place in the future).

Relationship between contract assets and receivables

- BC163 When an entity performs first by satisfying a performance obligation before the customer performs by paying the consideration, the entity has a contract asset—a right to consideration from a customer in exchange for goods or services transferred to the customer.
- BC164 In many cases, that contract asset is an unconditional right to consideration—a receivable—because nothing other than the passage of time makes payment of the consideration due. The boards decided that there was no need for the revenue recognition standard to address the accounting for receivables in addition to revenue recognition. Issues such as the subsequent measurement (or impairment) of receivables and disclosures relating to those assets are already addressed in IFRSs and US GAAP.
- BC165 Therefore the boards decided that once an entity has an unconditional right to consideration, the entity should present that right as a receivable separately from the contract asset and account for it in accordance with existing requirements. Consequently, contract assets are recognised in accordance with the proposed requirements when an entity has satisfied a performance obligation but does not yet have an unconditional right to consideration, for example because it first needs to satisfy another performance obligation in the contract.

BC166 In many cases, an unconditional right to consideration arises when the entity performs and issues an invoice for payment to the customer. For example, payment for goods or services is often due and an invoice is often issued when the entity has transferred the goods or services to the customer. However, the act of invoicing the customer for payment does not indicate whether the entity has an unconditional right to consideration. For instance, the entity may have an unconditional right to consideration before it invoices (unbilled receivable), if there is nothing but the passage of time before it is able to issue an invoice. In addition, in some cases an entity can have an unconditional right to consideration before it has satisfied a performance obligation. For example, an entity may enter into a non-cancellable contract that requires the customer to pay the consideration a month before the entity provides goods or services. On the date when payment is due, the entity has an unconditional right to consideration.

Disclosure (paragraphs 69–83)

BC167 Some of the main criticisms by regulators and users of existing revenue disclosures are that the disclosures are inadequate and lack cohesion with the disclosure of other items in the financial statements. For example, many users complain that entities present revenue in isolation so that users cannot relate revenue to the entity's financial position.

BC168 In the light of those deficiencies, the boards decided to propose a comprehensive and coherent set of disclosures to help users of financial statements understand and analyse how contracts with customers affect an entity's financial statements. In identifying the types of disclosures that might meet that objective, the boards initially considered:

- (a) the proposals from the Investors Technical Advisory Committee (ITAC) of the FASB for a 'principle-based' disclosure framework; and
- (b) the approaches adopted for disclosure in recent standards, including IFRS 7 *Financial Instruments: Disclosures*, and disclosures that were developed by the EITF for ASU 2009-13 (now ASC Section 605-25-50).

BC169 To be consistent with recent standards, the boards concluded that a comprehensive and coherent set of revenue disclosures should include:

- (a) an explanation of the composition of revenue recognised in a reporting period;

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- (b) a reconciliation of changes in contract asset and liability balances from period to period;
- (c) information about performance obligations and onerous performance obligations that the entity has with customers; and
- (d) an explanation of the judgements used in recognising revenue.

BC170 The boards' conclusions on the disclosure of this type of information are explained in paragraphs BC172–BC185.

Disclosure objective

BC171 Many recent standards specify a disclosure objective. The boards decided that the proposed requirements also should specify an objective for the revenue disclosures. The boards think that interpretation and implementation of the disclosure requirements improve if the overarching objective for the disclosures is clearly stated. That is because preparers can assess whether the overall quality and informational value of their revenue disclosures are sufficient to meet users' needs. The boards also observed that specifying a disclosure objective would avoid the need for detailed and prescriptive disclosure requirements to meet the specific information needs for the many and varied types of contracts with customers that are within the scope of the proposed requirements. The boards noted that developing principle-based disclosure requirements is necessary because it would not be possible or appropriate, given the objective of a single revenue standard, to develop specific requirements for specific transactions or industries.

Disaggregation of reported revenue

BC172 Revenue recognised in the statement of comprehensive income is a composite amount arising from many contracts with customers. The revenue could arise from the transfer of different goods or services or from contracts involving different types of customers or markets. The disclosure of disaggregated revenue information helps users to understand the composition of the revenue that has been recognised in a reporting period. The level of disaggregation is important—information is obscured if the disclosure of that information is either too aggregated or too granular.

BC173 The boards observed that existing standards require revenue to be disaggregated and that those standards specify the basis for the disaggregation. For example:

- (a) IAS 18 requires disclosure of the amount of each significant category of revenue recognised during the period, including revenue arising from the sale of goods, the rendering of services, interest, royalties and dividends.
- (b) IFRS 8 *Operating Segments* and ASC Topic 280 on segment reporting require an entity to disclose revenue for each operating segment (reconciled to total revenue) and to disaggregate its total revenue by products or services (or by groups of similar products or services) and by geography to the extent that the entity's operating segments are not based on different products or services or different jurisdictions. Related disclosure is required on the entity's types of products and services and its major customers. However, the amounts disclosed can be measured on a basis that is used internally and might not accord with the other measurements used for other purposes in IFRSs or US GAAP.

BC174 Feedback from users consulted on revenue disclosures indicated that the basis for meaningfully disaggregating revenue will not be uniform. Depending on the circumstances, the most useful disaggregation could be by type of good or service, by geography, by market or type of customer, or by type of contract. The boards were persuaded by this view and concluded that the proposed requirements should not prescribe a specific characteristic of revenue to be used as the basis for disaggregation. Instead, the boards propose that an entity should disaggregate revenue into categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

BC175 The Financial Statement Presentation project is considering a presentation approach whereby an entity would disaggregate income and expense by nature and by function. That approach is similar to the disaggregation requirement in paragraph 74 of these proposed requirements. The boards will consider whether separate disaggregation requirements are necessary for revenue when they review feedback on the Financial Statement Presentation project.

Reconciliation of contract balances

BC176 For users to assess the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, they need to understand the relationship between the revenue recognised in a reporting period and the contract asset and liability balances. Among other things, this includes identifying whether the entity typically

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receives payment before or after transferring goods or services to the customer and quantifying the relationship between revenue recognised and cash flows. Although entities currently recognise working capital balances at each reporting date, such as trade receivables and deferred revenue, users have indicated that the relationship between those balances and the revenue recognised in the period is unclear. Therefore, to clarify that relationship, the boards decided that an entity should disclose a reconciliation of the contract asset and liability balances. The entity could present the reconciliation gross or net.

- BC177 A gross reconciliation would show the remaining contractual rights and performance obligations in separate columns with a total net amount that links to the statement of financial position. In doing so, the reconciliation would highlight the amount of new contracts obtained and the amount of unsatisfied performance obligations and, hence, indicate the amount of revenue expected to be recognised in the future as a result of contracts that already exist. The boards acknowledged that this information would be useful to users of financial statements. However, they also noted:
- (a) the high cost of preparing and auditing the reconciliation because an entity would be required to measure all unperformed contracts, including executory contracts;
 - (b) the high level of judgement inherent in executory contracts, including determining when a contract comes into existence; and
 - (c) the information provided may not be useful for many types of contracts, such as those with a short duration.
- BC178 Hence, the boards decided that an entity should disclose a reconciliation from the opening to the closing aggregate balance of the (net) contract assets and (net) contract liabilities. However, the boards understand that users are mainly interested in a gross reconciliation because it would result in the disclosure of performance obligations on a gross basis. Therefore, they decided that an entity should also disclose a maturity analysis that shows the amount of its remaining performance obligations and the expected timing of their satisfaction.
- BC179 The boards think that the separate disclosure of remaining performance obligations would enable users:
- (a) to assess the risks associated with future revenues. In general, users see the outcome as more uncertain the further out is the satisfaction of the performance obligation because it will be

subject to a greater number of factors and uncertainties than will a more immediately satisfied performance obligation.

- (b) to understand the timing and amount of revenue to be recognised from existing contracts.
- (c) to analyse trends in the amount and timing of revenue.
- (d) to obtain consistency in the reporting of 'backlog', which is often disclosed by entities in management commentary but calculated on a variety of bases.
- (e) to understand how changes in judgements or circumstances might affect the pattern of revenue recognition.

BC180 The boards acknowledge that the relevance of a maturity analysis diminishes if those performance obligations arise from contracts that are satisfied shortly after contract inception. Feedback from users indicated that this information is mainly useful for longer-term contracts, such as construction contracts and service arrangements. For that reason, the proposed requirements limit the disclosure of the maturity analysis to contracts with an original duration of more than one year.

Description of performance obligations

BC181 Existing standards require entities to disclose their accounting policies for recognising revenue (see paragraph 10(e) of IAS 1 *Presentation of Financial Statements* or the guidance on notes to financial statements—disclosures in ASC Section 235-10-50). However, users have suggested that, in many cases, entities provide a 'boilerplate' description of the accounting policy adopted without explaining how the accounting policy relates to the contracts that the entity enters into with customers.

BC182 The boards' proposals would not change those requirements. However, in response to the concerns raised by users, paragraph 77 would require an entity to provide more descriptive information about its performance obligations.

Onerous performance obligations

BC183 The boards decided that the disclosures relating to onerous performance obligations should be consistent with the existing onerous contract disclosures in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Assumptions and uncertainties

- BC184 IFRSs and US GAAP have general requirements for the disclosure of significant accounting estimates and judgements made by an entity. Because of the importance placed on revenue by users of financial statements, the boards decided that the proposed requirements should include specific disclosures on the estimates used and judgements made in determining the amount and timing of revenue recognition.
- BC185 The EITF reached a similar conclusion when developing the requirements in ASC Section 605-25-50 for the disclosure of multiple-element arrangements. The EITF consulted extensively to develop disclosures to communicate the judgements used and their effect on the recognition of revenue from multiple-element arrangements. After considering whether those disclosures could apply appropriately to all contracts with customers, the boards decided that the proposed requirements should include disclosures on significant judgements that are similar to those required by ASC Section 605-25-50.

Application guidance (paragraphs B1–B96)

- BC186 The boards decided to include application guidance to clarify how the principles in the proposed requirements would apply to features found in various typical contracts with customers. Some of that application guidance is based on existing guidance in IFRSs or US GAAP. Consistently with the objective of developing a single revenue recognition model (as discussed in paragraphs BC3 and BC4), the boards do not intend to provide guidance that would apply only to specific industries.

Sale of a product with a right of return (paragraphs B5–B12)

- BC187 In the discussion paper, the boards identified two approaches for accounting for goods sold with a right of return:
- (a) a performance obligation approach, whereby the promise to provide a return right is a performance obligation. Under this approach, an entity would allocate some of the transaction price in the contract to that performance obligation and recognise it as revenue when the entity provides return services.
 - (b) a failed sale approach, whereby revenue (and costs of sales) is recognised only for goods transferred to customers that are

expected to result in successful sales (ie sales that will not fail). Under this approach, the promise to accept returns would not be a performance obligation.

- BC188 The boards did not express a preliminary view in the discussion paper but invited comment on the issue. The views from respondents were mixed. Some respondents disagreed with the performance obligation approach because it would result in the entity recognising revenue as goods are returned, which they thought was inappropriate because the entity does not retain consideration from customers who return their goods. Furthermore, they observed that the performance obligation approach seems to result in recognition of more revenue than the amount of consideration ultimately retained by the entity. Other respondents disagreed with the failed sale approach because the entity would continue to recognise as inventory the goods expected to be returned even though customers have obtained control of those goods.
- BC189 In the light of the feedback from respondents and the boards' subsequent decisions on variable consideration, the boards refined their analysis of rights of return. The boards concluded that contracts with a right of return typically include at least two performance obligations—a performance obligation to provide the good to the customer and a performance obligation for the return right service, which is a stand-ready obligation to accept the goods returned by the customer during the return period.
- BC190 In relation to performance obligations to provide goods to customers, the boards concluded that an entity has made an uncertain number of sales when it provides goods with a return right. That is because it is only after the return right expires that the entity will know with certainty how many sales it has made (ie how many sales did not fail). Therefore, the boards decided that an entity should not recognise revenue for sales that are expected to fail because the customer will exercise their return rights.
- BC191 Measuring revenue from contracts with return rights can also be viewed as analogous to measuring variable consideration. The return right means that the transaction price—and therefore the amount of revenue—is uncertain at the point of sale. Consistently with their decisions on variable consideration, the boards decided that revenue should be measured at the expected (probability-weighted) amount of consideration that the entity will retain. Therefore, the entity recognises

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a liability for its obligation to refund amounts to customers for those sales that are expected to fail. That refund liability would be measured at the expected (probability-weighted) amount of refunds and credits (for example, a store credit) provided to customers.

- BC192 The boards also considered whether to account for the return right service as a performance obligation separate from the refund liability, by allocating the transaction price between the performance obligation to provide the good and the performance obligation for the return right service. The boards expect that a return right would generally result in a separate performance obligation because it is functionally distinct from the underlying goods provided under the contract and has a distinct profit margin. Moreover, if an entity does not recognise a performance obligation for the return right service, it will have recognised all of the revenue and margin in the contract once the customer obtains control of the good. Such an outcome might not faithfully depict the entity's performance under the contract.
- BC193 However, the boards also observed that accounting for the return right as a performance obligation would typically require the entity to estimate the stand-alone selling price of that service. In many cases, the number of returns is expected to be a small percentage of the total sales and the return period is often short (such as 30 days). Therefore, the boards concluded that the incremental information provided to users by accounting for the return right service as a performance obligation would not justify the complexities and costs of doing so. Accordingly, the boards decided that an entity should not account for a return right service as a separate performance obligation.
- BC194 The boards also considered how to account for goods that are returned to the entity in saleable condition. The boards concluded that an entity should not recognise as inventory the products expected to be returned by customers. That is because a right of return does not preclude customers from directing the use of, and receiving the benefit from, goods they have purchased with a right of return. However, the entity would have a contractual right to recover the good from the customer if the customer exercises its option to return the good and obtain a refund. The boards concluded that the right to recover the inventory asset should be recognised separately from the refund liability because that provides greater transparency and ensures that the asset is considered for impairment testing.

Product warranties and product liabilities (paragraphs B13–B19)

- BC195 In the discussion paper, the boards proposed that all product warranties (whether described as a manufacturer’s warranty, a standard warranty or an extended warranty) give rise to a separate performance obligation for an entity—the promised service being warranty coverage. Those warranties require an entity to stand ready to replace or repair the product over the term of the warranty. Consequently, in any contract for the sale of a product that includes a warranty, an entity would allocate some of the transaction price to the warranty on a relative selling price basis and recognise that amount as revenue only when the promised warranty services transfer to the customer.
- BC196 Most respondents did not support the boards’ proposals. They either:
- (a) disagreed that all warranties give rise to separate performance obligations; or
 - (b) questioned whether identifying a separate performance obligation would provide sufficiently useful information to justify the cost and effort, especially if the warranty period is relatively short.
- BC197 In the light of the feedback from respondents, the boards decided to draw a distinction between warranties that provide the customer with coverage for:
- (a) defects that exist when the product is transferred to the customer (a ‘quality assurance warranty’); and
 - (b) faults that arise after the product is transferred to the customer (an ‘insurance warranty’).

Quality assurance warranty

- BC198 A quality assurance warranty is a promise that the product is free from defects at the time of sale. The boards concluded that this promise does not provide any additional service to the customer—the entity and the customer entered into a contract for the transfer of a product that was not defective. Consequently, a quality assurance warranty in a contract with a customer is not a performance obligation.
- BC199 The boards considered viewing a quality assurance warranty as either:
- (a) a liability to replace or repair a defective product; or

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- (b) an unsatisfied performance obligation because the entity has not provided the customer with a product that is free from defects at the time of sale.
- BC200 If an entity is viewed as having a liability to replace or repair a defective product, it would recognise revenue once it transfers the product to the customer. The entity would then judge, using all the available evidence, whether the product was defective and, if so, recognise a separate liability for its obligation to replace or repair that product in accordance with IAS 37 or ASC Topic 460 on guarantees. That approach would be similar to current practice for warranties that are neither separately priced nor for an extended term (under US GAAP) or a separately identifiable component of the sales contract (under IFRSs).
- BC201 If an entity is viewed as having an unsatisfied performance obligation, the uncertainty about whether the product was defective when transferred to the customer means that it is uncertain whether the entity satisfied its performance obligation. The entity would judge, on the basis of all the available evidence, whether the product was defective and, if so, continue to recognise the performance obligation for that product.
- BC202 To be consistent with the accounting for rights of return, the boards concluded that an entity has an unsatisfied performance obligation if it transfers to a customer a defective product that is subject to a quality assurance warranty. In other words, the sale has failed.
- BC203 The boards rejected the alternative of recognising the warranty as a separate liability because, if that liability is measured at cost (as it would be at present under ASC Topic 460), the entity would recognise all of the revenue and all of the margin in the contract when the product transfers to the customer. The boards concluded that an entity should not recognise all of the margin in a contract before it has satisfied all its performance obligations under the contract.

Insurance warranty

- BC204 An entity providing an insurance warranty is providing a service in addition to the promise to provide a product that was not defective at the time of sale. The entity is promising to repair or replace the product if it breaks down within a specified period (normally subject to some conditions). This additional service to the customer is a performance obligation and meets the definition of an insurance contract. (Although, in the Insurance Contracts project, the boards have tentatively decided that warranties issued directly by a manufacturer, dealer or retailer would be within the scope of these proposed requirements.)

BC205 In some jurisdictions, the law requires an entity to provide warranties with the sale of its products. The law might state that an entity is required to repair or replace products that develop faults within a specified period from the time of sale. Consequently, these statutory warranties may appear to be insurance warranties because they would cover faults arising after the time of sale, not just defects existing at the time of sale. However, in many such cases, the boards concluded that the law can be viewed as simply operationalising a quality assurance warranty. In other words, the objective of these statutory warranties is to protect the customer against the risk of purchasing a defective product. But rather than having to determine whether the product was defective at the time of sale, the law presumes that if a fault arises within a specified period (which can vary depending on the nature of the product), the product was defective at the time of sale. Therefore, these statutory warranties should be accounted for as quality assurance warranties.

Product liability laws

BC206 Some respondents to the discussion paper questioned whether product liability laws give rise to performance obligations. These laws typically require an entity to pay compensation if one of its products causes harm or damage. The boards concluded that an entity should not recognise a performance obligation arising from these laws because the performance obligation in a contract with a customer is to provide a product that is not defective. The entity would satisfy that obligation by supplying a product that is not defective.

BC207 Any obligation of the entity to pay compensation for the damage or harm that its product causes is separate from the performance obligation. The boards noted that an entity would account for this obligation separately from the contract with the customer and in accordance with IAS 37 or the guidance on loss contingencies in ASC Subtopic 450-20.

Principal versus agent considerations (paragraphs B20–B23)

BC208 Existing standards require an entity to assess whether it is acting as a principal or an agent when goods or services are transferred to end customers. That assessment determines whether an entity recognises revenue for the gross amount of customer consideration (if the entity is a principal) or for a net amount after the principal is compensated for its goods or services (if the entity is an agent). Under the proposed requirements, principals and agents would have different performance

obligations. A principal controls the goods or services before they are transferred to customers. Consequently, the principal's performance obligation is to transfer those goods or services to the customer. In contrast, an agent does not control the goods or services before they are transferred to customers. The agent facilitates the sale of goods or services between a principal and the customer. Therefore, an agent's performance obligation is to arrange for another party to provide the goods or services to the customer. The transaction price attributable to an agent's performance obligation is the fee or commission that the agent receives for providing those services.

- BC209 It may not always be readily apparent whether an entity has obtained control of goods or services before they are transferred to a customer. Similar issues arise in consignment sales. For that reason, the boards have included in the proposed application guidance some indicators that a performance obligation relates to an agency relationship. They are based on the indicators specified in the guidance on principal agent considerations in ASC Subtopic 605-45 and in the illustrative examples accompanying IAS 18.

Customer options for additional goods or services

Identifying the performance obligation (paragraphs B24–B26)

- BC210 In the discussion paper, the boards highlighted the fact that at least some options for additional goods or services would be performance obligations in a contract with a customer. However, the boards did not decide when an option for additional goods or services is a performance obligation in an existing contract. Respondents to the discussion paper had differing views on whether some or all options for additional goods or services would be performance obligations.
- BC211 In subsequent discussions, the boards observed that it can be difficult to distinguish between:
- (a) an option that the customer pays for (often implicitly) as part of an existing contract—which would be a performance obligation to which part of the transaction price is allocated; and
 - (b) a marketing or promotional offer that the customer did not pay for and, although made at the time of entering into a contract, is not part of the contract—which would not be a performance obligation in that contract.

BC212 Similar difficulties in distinguishing between an option and an offer have arisen in US GAAP for the software industry. In response to those practice issues, ASC Section 985-605-15 indicates that an offer of a discount on future purchases of goods or services would be presumed to be a separate option in the contract if that discount is significant and is incremental both to the range of discounts reflected in the pricing of other elements in that contract and to the range of discounts typically given in comparable transactions. The boards propose similar criteria to differentiate between an option and a marketing or promotional offer. However, to avoid implying that *significant* and *material* are intended to be different recognition thresholds, the boards refer to the materiality of the right to acquire additional goods or services rather than the significance of that right.

Allocating the transaction price (paragraphs B86–B88)

BC213 In accordance with the proposed requirements, the entity must determine the stand-alone selling price of the option so that part of the transaction price is allocated to the performance obligation. In some cases, the stand-alone selling price of the option may be directly observable or it may be indirectly observable by, for example, comparing the observable prices for the goods or services with and without the option. In many cases, though, the stand-alone selling price of the option would need to be estimated.

BC214 Option pricing models can be used to estimate the stand-alone selling price of an option. The price of an option includes the intrinsic value of the option (ie the value of the option if it were exercised today) and its time value (ie the value of the option that depends on the time until the expiry and the volatility of the price of the underlying goods or services). The boards decided that the benefits to users of allocating some of the transaction price to the price and availability guarantees inherent in the time value component of the option price would not justify the costs and difficulties to do so. However, the boards concluded that an entity should be able to readily obtain the inputs necessary to measure the intrinsic value of the option in accordance with paragraph B87 and those calculations should be relatively straightforward and intuitive. This measurement approach is consistent with the measurement application guidance for customer loyalty points in IFRIC 13 *Customer Loyalty Programmes*.

Renewal options

- BC215 A renewal option gives a customer the right to acquire additional goods or services of the same type as those supplied under an existing contract. The option could be described as a renewal option within a relatively short contract (for example, a one-year contract with an option to renew that contract for a further year at the end of the first and second years) or a cancellation option within a longer contract (for example, a three-year contract that allows the customer to discontinue the contract at the end of each year). A renewal option could be viewed similarly to other options to provide additional goods or services. In other words, the renewal option could be a separate performance obligation in the contract if it provides the customer with a material right that the customer could not otherwise obtain without entering into that contract.
- BC216 However, in cases in which a renewal option provides the customer with a material right, there typically is a series of options. In other words, to exercise any option in the contract, the customer must have exercised all the previous options in the contract. The boards concluded that determining the stand-alone selling price of a series of options would be complex. That is because determining the estimated stand-alone selling prices of the options would require an entity to identify various inputs, such as the stand-alone selling prices for the goods or services for each renewal period and the likelihood that customers will renew for the subsequent period. In other words, the entity would have had to consider the entire potential term of the contract in order to determine the amount of the transaction price from the initial period that should be deferred until later periods.
- BC217 For that reason, the boards concluded that it would be simpler for the entity to view a contract with renewal options as a contract for its expected term (ie including the expected renewal periods) determined on a probability-weighted basis, rather than as a contract with a series of options. Under this approach, an entity would include the optional goods or services that it expects to provide (and corresponding expected customer consideration) in the initial measurement of the contract.
- BC218 The boards concluded that it would be preferable to reflect uncertainty about the term of the contract in the measurement of the contract rather than, say, on the basis of its most likely term because that approach better reflects the uncertainty of the entity's contract—ie the existence of the

option. Furthermore, although each individual contract might not run for the expected term, using a probability-weighted approach more appropriately reflects the economics when there is a portfolio of contracts.

- BC219 The boards propose two criteria to distinguish renewal options from other options to acquire additional goods or services. First, the additional goods or services underlying the renewal options must be similar to those provided under the initial contract—ie the entity continues to provide what it was already providing. Therefore, it is more intuitive to view the goods or services underlying such options as part of the initial contract. In contrast, customer loyalty points and many discount vouchers would be considered to be separate deliverables in the contract because the underlying goods or services may be of a different nature.
- BC220 The second criterion is that the additional goods or services in the subsequent contracts must be provided in accordance with the terms of the original contract. Consequently, the entity's position is constrained—it cannot change those terms and conditions and, in particular, it cannot change the pricing of the additional goods or services beyond the parameters specified in the original contract. That is different from examples such as customer loyalty points and discount vouchers. For instance, if an airline frequent flyer programme offers 'free' flights to customers, the airline is not constrained because it can subsequently determine the number of points that are required to be redeemed for any particular 'free' flight. Similarly, when an entity grants discount vouchers, typically it has not constrained itself with respect to the price of the subsequent goods or services against which the discount vouchers will be redeemed.

Licensing and rights to use (paragraphs B31–B39)

- BC221 Many respondents to the discussion paper questioned how an entity would identify performance obligations in a contract in which an entity licenses its intellectual property by granting a customer the right to use that property. Hence, the boards decided to develop application guidance on the issue.
- BC222 The boards noted that some contracts would be accounted for as a sale, rather than a licence, of intellectual property because the customer obtains control of that intellectual property. That would be the case if an entity grants the exclusive right to use intellectual property for substantially all of its remaining economic life.

- BC223 When developing application guidance, the boards observed that licensing arrangements that are not sales of intellectual property often have characteristics similar to those of a lease. In both cases, a customer purchases the right to use an asset of the entity. The boards decided tentatively in the Leases project that a lessor should recognise revenue during the term of the lease as the lessor permits the lessee to use its asset. However, the boards thought that this pattern of revenue recognition would not be appropriate for all licences of intangible assets. Consequently, the boards considered the following potential differences between a licensing arrangement and a lease:
- (a) tangible versus intangible—the boards decided that it would be difficult to justify why the accounting for a promised asset should differ depending on whether the asset is tangible or intangible. Moreover, in the FASB’s Conceptual Framework, the discussion on the nature of assets de-emphasises the physical nature of assets.
 - (b) exclusive versus non-exclusive—leases, by nature, are exclusive because the lessor cannot grant the right to use a leased asset to more than one lessee at the same time. In contrast, an entity can grant similar rights to use some intellectual property to more than one customer under substantially the same terms.
- BC224 Consequently, the boards decided that an entity should account for a promise to grant an exclusive right to use intellectual property (which is not a sale of that intellectual property) consistently with their tentative decisions on how a lessor would account for the promise to grant a right to use a tangible asset. That right to use gives rise to a performance obligation that is satisfied continuously over time as the entity permits the customer to use the property over time. Because the entity cannot grant a similar right to more than one customer at the same time, the entity’s use of the intellectual property during the licence term is constrained for a period of time. In the boards’ view, that constraint over time suggests that the entity has a performance obligation that is not fully satisfied until the end of the licence term. The boards will review their tentative decisions in the light of feedback on the proposed requirements and further discussions in the Leases project.
- BC225 A licence is non-exclusive if the entity continues to retain and control its intellectual property and can use that property to grant similar licences to other customers under substantially the same terms. In other words, the entity’s rights to its intellectual property are not diminished by granting non-exclusive licences. In those cases, the entity is granting the customer an asset that is separate from the entity’s intellectual property.

For example, a payroll processing software product contains intellectual property, but the customer's asset is the use and benefit of payroll processing and not access to the entity's intellectual property (ie the source code). Similarly, when a customer purchases a dress, that dress contains intellectual property for its design, but the customer's asset is the use and benefit of the dress.

- BC226 The boards noted that licensing intellectual property on a non-exclusive basis often is the only way an entity can distribute its product and protect its intellectual property from the unauthorised duplication of its products. They concluded that the asset transferred with a licence is, in principle, similar in nature to the promised asset in a sale of any product. Hence, the legal distinction between a licence and a sale should not cause revenue recognition on non-exclusive licences to differ from the sale of other types of products.

Product financing arrangements (paragraph B51)

- BC227 If an entity enters into a contract with a repurchase agreement and the customer does not obtain control of the asset, the contract is a financing arrangement if the price at which the entity repurchases the asset (after reflecting the time value of money) is equal to or more than the original sales price of the asset.
- BC228 The FASB noted that if a repurchase agreement is a financing arrangement, an entity applying US GAAP could apply the guidance on product financing arrangements in ASC Subtopic 470-40. However, IFRSs do not have an equivalent standard (the illustrative examples accompanying IAS 18 acknowledge the possibility of a financing arrangement but do not specify the accounting).
- BC229 Therefore, to ensure consistent accounting in IFRSs and US GAAP for a financing arrangement that arises from a contract with a customer, the boards decided to provide guidance consistent with ASC Subtopic 470-40.
- BC230 Consequently, the FASB decided to withdraw ASC Subtopic 470-40. It noted that the remaining guidance in ASC Subtopic 470-40 addresses situations in which an entity arranges for another party to purchase products on its behalf and agrees to purchase those products from the other party. In those cases, the entity is required to recognise the products as an asset and to recognise a related liability when the other party purchases the product. The FASB noted that the proposed model would result in similar accounting when the other party acts as an agent of the entity (ie the other party does not obtain control of the products).

Transition (paragraph 85)

- BC231 The boards decided that an entity should apply the proposed requirements retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* or the guidance on accounting changes in ASC Topic 250. Retrospective application would provide users of financial statements with useful trend information because transactions would be recognised and measured consistently both in the current period and in the comparative periods presented. The boards think that it is particularly important for users to be able to understand trends in revenue, given its significance to the financial statements.
- BC232 The boards noted that retrospective application could be burdensome for some entities preparing financial statements, particularly those entities with many long-term contracts. In addition, some entities might find it difficult to estimate stand-alone selling prices at contract inception and variable consideration throughout the contract without using hindsight. However, the boards noted that some of those concerns would be addressed by:
- (a) IAS 8 and ASC Topic 250 limiting the retrospective application of an accounting policy if it is impracticable; and
 - (b) the boards contemplating a long lead time between issuing a standard on revenue from contracts with customers and its effective date, which would reduce the extent of hindsight needed in applying that standard.
- BC233 Nonetheless, on the basis of that assessment of the potential costs associated with retrospective application, the boards also considered whether the proposed requirements should instead apply:
- (a) on a prospective basis, either for all new contracts from a specified date or for all contracts (new and existing) from that date; or
 - (b) on a limited retrospective basis.
- BC234 The boards rejected the alternative of applying the proposed requirements prospectively because the recognition and measurement of revenue arising from new contracts and existing contracts would not be comparable between the current period and the comparative periods. Moreover, if the requirements were applied prospectively only for new contracts, the recognition and measurement of revenue would not be comparable in the current period.

BC235 The boards considered whether limiting the retrospective application of the proposed requirements would address some of those preparer concerns and still provide comparable revenue information to users of financial statements. Various alternatives for limiting the retrospective application of the proposed requirements were considered. Those alternatives were based on applying the proposed requirements retrospectively to all contracts except those contracts that are completed at a specified date. That could be a date in the past or a date after the effective date of the proposed requirements. However, the boards were unable to identify a specific date for limiting the retrospective application of the proposed requirements that, on cost-benefit grounds, would be preferable to full retrospective application.

Effective date and early adoption (paragraph 84)

BC236 The boards will consider collectively the effective dates and transition for the standards—including revenue recognition—that they have targeted to issue in 2011 and, as part of that consideration, will publish a separate consultation paper to seek comments from interested parties. Hence, the boards may modify their previously stated preferences in the case of some individual standards. As part of that consideration, the boards also will address whether early adoption of the standard on revenue from contracts with customers should be permitted.

BC237 Consequently, the proposed requirements do not specify a possible effective date or whether the proposed requirements could be adopted early, but the boards intend to provide enough time to implement the proposed changes.

BC238 The FASB has indicated a preference to prohibit entities adopting the standard early. The IASB considered the related implications for IFRS 1 *First-Time Adoption of International Financial Reporting Standards* and decided that IFRS 1 should not provide any exceptions to, or exemptions from, the proposed requirements for first-time adopters of IFRSs. To avoid requiring two changes in a short period, the IASB proposes that first-time adopters should be permitted to adopt the standard early.

Costs and benefits

- BC239 The objective of financial statements is to provide information about an entity's financial position, financial performance and cash flows that is useful to a wide range of users in making economic decisions. To attain that objective, the boards try to ensure that a proposed standard will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. Present investors primarily bear the costs of implementing a new standard. Although those costs might not be borne evenly, users of financial statements benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital, including credit, and the efficient allocation of resources in the economy.
- BC240 The evaluation of costs and benefits is necessarily subjective. In making their judgement, the boards consider the following:
- (a) the costs incurred by preparers of financial statements;
 - (b) the costs incurred by users of financial statements when information is not available;
 - (c) the comparative advantage that preparers have in developing information, compared with the costs that users would incur to develop surrogate information; and
 - (d) the benefit of better economic decision-making as a result of improved financial reporting.
- BC241 The boards propose a single standard that would recognise revenue on a consistent and comparable basis for a wide range of contracts with customers. By accounting for those contracts consistently, the proposed standard would address many of the weaknesses and inconsistencies inherent in existing revenue requirements, which have contributed to the existence of diverse practices in the recognition of revenue and, as a result, frequent requests for authoritative guidance on applying those existing requirements to specific transactions or other emerging issues.
- BC242 In addition, a single revenue recognition standard would improve comparability in the recognition, measurement and disclosure of revenue across transactions and across entities operating in various industries. Users have indicated that comparable revenue information is useful when assessing the financial performance of an entity and

assessing financial performance across a number of entities. Moreover, a common revenue standard would make the financial reporting of revenue comparable between entities that prepare financial statements in accordance with IFRSs or US GAAP.

- BC243 The boards acknowledge that some preparers and users do not perceive significant weaknesses in some existing revenue standards or in the financial information resulting from applying those standards to some industries. Those preparers and users have therefore questioned whether the benefits from applying a new standard in some industries would be justified by the costs involved in implementing that new standard. However, the boards concluded that the overall benefits to financial reporting that would result from a single revenue standard being applied consistently across different industries, jurisdictions and capital markets outweigh the concerns about cost-benefit assessments in particular industries. In addition, in developing their proposals, the boards have also carried forward some existing requirements where appropriate. That would reduce the amount of change for some entities on implementing a new standard.
- BC244 The proposed requirements would change existing revenue recognition practices and some entities would need to make systems and operational changes to comply with the proposed requirements. For example, some preparers have indicated that systems changes would be necessary to estimate variable consideration and contract options. The boards think that the costs of those changes would be incurred primarily during the transition from existing standards to the proposed standard, whereas the benefits resulting from increased consistency and comparability in the recognition of revenue would be ongoing.
- BC245 The proposed disclosure requirements are more substantial than those required in existing standards. The boards think that the proposed disclosures would provide users with additional information that explains more clearly the relationship between an entity's contracts with customers and the revenue recognised by the entity in a reporting period. Some users have commented that the proposed disclosures would address deficiencies that exist currently in revenue disclosures.
- BC246 As noted in paragraph BC6, since the discussion paper was published, members and staff of the boards have consulted users and preparers across a wide range of industries and jurisdictions. This has allowed the boards to better understand some of the operational issues arising from their proposals. As a result, the boards have modified some of their

preliminary views in the discussion paper to reduce the burden of implementing the proposed revenue recognition model. The boards will continue to consult widely following publication of the proposed requirements.

- BC247 On balance, the boards concluded that the proposed requirements would improve financial reporting under IFRSs and US GAAP at a reasonable cost. In arriving at that conclusion, the boards acknowledged that the assessments of costs versus benefits would be different under IFRSs and US GAAP.

Consequential amendments

Sales of assets that are not an output of an entity's ordinary activities

- BC248 ASC Subtopic 360-20 on real estate sales provides guidance for recognising profit on all real estate sales, regardless of whether real estate is an output of an entity's ordinary activities.
- BC249 A contract for the sale of real estate that is an output of an entity's ordinary activities meets the definition of a contract with a customer and, therefore, would be within the scope of the proposed requirements. Consequently, the FASB considered the implications of retaining the guidance in ASC Subtopic 360-20 for other contracts. The FASB noted that the recognition of the profit or loss on a real estate sale would differ depending on whether the transaction is a contract with a customer. However, economically there is little difference between the sale of real estate that is an output of the entity's ordinary activities and real estate that is not. Hence, the difference in accounting should relate only to the presentation of the profit or loss in the statement of comprehensive income—revenue and expense, or gain or loss.
- BC250 Therefore, the FASB decided to amend ASC Subtopic 360-20 to require an entity to apply the recognition and measurement principles of the proposed requirements to contracts for the sale of real estate that is not the output of the entity's ordinary activities. However, the entity would not recognise revenue but instead would recognise a gain or a loss.
- BC251 The FASB also decided to specify that an entity should apply the recognition and measurement principles of the proposed requirements to contracts for the sale of other tangible assets within the scope of ASC Topic 360 on property, plant and equipment and intangible assets within

the scope of ASC Topic 350 on goodwill and other intangibles. The primary reason for that decision was the lack of guidance in US GAAP on accounting for the sale of those assets when they are not an output of an entity's ordinary activities and do not constitute a business or non-profit activity.

- BC252 In IFRSs, an entity selling an asset within the scope of IAS 16 *Property, Plant and Equipment*, IAS 38 or IAS 40 *Investment Property* applies the recognition principles of IAS 18 to determine when to derecognise the asset and, in determining the gain or loss on the sale, measures the consideration at fair value. However, the IASB understands that there is diversity in practice when the sale of those assets involves contingent consideration. Accordingly, to improve the accounting in IFRSs and ensure consistency with US GAAP, the IASB decided to amend those standards to require an entity to apply the recognition and measurement principles of the proposed requirements to sales of assets within the scope of those standards. The IASB decided that a *reasonably estimated* constraint on the transaction price should also apply to the sale of assets that are not an output of the entity's ordinary activities because entities face similar if not greater challenges in determining the transaction price when the asset is not an output of the entity's ordinary activities than when the asset is an output of its ordinary activities.