Applying IFRS

A closer look at IFRS 15, the revenue recognition standard

IFRS 15 *Revenue from Contracts with Customers*

(Updated October 2020)

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Overview

IFRS 15 *Revenue from Contracts with Customers* (IFRS 15 or the standard) provides accounting requirements for all revenue arising from contracts with customers. It affects all entities that enter into contracts to provide goods or services to their customers, unless the contracts are in the scope of other IFRSs, such as the leases standard. The standard, which is largely converged with the revenue guidance in US GAAP, also specifies the accounting for costs an entity incurs to obtain and fulfil a contract to provide goods or services to customers (see section 9.3) and provides a model for the measurement and recognition of gains and losses on the sale of certain non-financial assets, such as property, plant or equipment (see section 2.2.1).

As a result, entities that adopted the standard often found implementation to be a significant undertaking. This is because the standard requires entities to make more judgements and estimates and affects entities' financial statements, business processes and internal controls over financial reporting. The complexity of the standard has also led to further standard setting and regulatory discussion, which continues to contribute to the overall understanding on how the standard should be applied.

While entities are now more familiar with its requirements, the application of IFRS 15 continues to be challenging for them when business practices evolve and operating environments change, raising new implementation questions. For example, during, and because of, the coronavirus pandemic, areas that may be affected for revenue contracts include, but are not limited to, variable consideration, contract modifications and terminations, collectability and any extended payment terms, customer incentives and changes to selling prices, onerous contracts and capitalised contract costs. See our publication, *Applying IFRS*, *Accounting considerations of the coronavirus pandemic*, which provides considerations for entities on the potential effects of the coronavirus pandemic.[1]

Following the issuance of their revenue standards, the International Accounting Standards Board (IASB or the Board) and the US Financial Accounting Standards Board (FASB) (collectively, the Boards) created the Joint Transition Resource Group for Revenue Recognition (TRG) to help them determine whether more application guidance was needed. TRG members included financial statement preparers, auditors and other users from a variety of industries and countries, as well as public and private entities. Members of the joint TRG met six times in 2014 and 2015, and members of the FASB TRG met twice in 2016.

TRG members' views are non-authoritative, but entities should consider them as they implement the standards. In its July 2016 public statement, the European Securities and Markets Authority (ESMA) encouraged issuers to consider the TRG discussions when implementing IFRS 15.[2] Furthermore, the former Chief Accountant of the US Securities and Exchange Commission (SEC) encouraged SEC registrants, including foreign private issuers (that may report under IFRS), to consult with his office if they are considering applying the standard in a manner that differs from the discussions in which TRG members reached general agreement.[3] We have incorporated our summaries of topics on which

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1 Available on ey.com/IFRS.

2 ESMA Public Statement: *Issues for consideration in implementing IFRS 15: Revenue from Contracts with Customers*, issued 20 July 2016, available on ESMA's website.

3 Speech by Wesley R. Bricker, 5 May 2016. Available on the SEC's website.

TRG members generally agreed throughout this publication. Unless otherwise specified, these summaries represent the discussions of the joint TRG. Where possible, we indicate if members of the IASB or its staff commented on the FASB TRG discussions.

This publication discusses the IASB's standard (including all amendments) and highlights significant differences from the FASB's standard, Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*.[4] It also addresses topics on which the members of the TRG reached general agreement and our views on certain topics.

The views we express in this publication may evolve as application issues are identified and discussed among stakeholders. The conclusions we describe in our illustrations are also subject to change as views evolve. Conclusions in seemingly similar situations may differ from those reached in the illustrations due to differences in the underlying facts and circumstances. Please see ey.com/IFRS for our most recent revenue publications.

[4] Throughout this publication, when we refer to the FASB's standard, we mean ASC 606 (including all amendments), unless otherwise noted.

Contents

What you need to know

- IFRS 15 provides a single source of revenue requirements for all entities in all industries.
- IFRS 15 applies to revenue from contracts with customers, unless explcitily excluded from the scope (e.g., leasing contracts, financial instruments).
- IFRS 15 is principles-based and includes detailed application guidance. The lack of bright lines requires the use of judgement.
- While entities are more familiar with its requirements, application of IFRS 15 continues to be challenging for entities as business practices evolve and operating environments change.
- IFRS 15 also specifies the accounting treatment for certain items not typically thought of as revenue, such as certain costs associated with obtaining and fulfilling a contract and the sale of certain non-financial assets.

1. Overview of the standard (updated October 2020)

The revenue standards that the Boards issued in May 2014 were largely converged and superseded virtually all legacy revenue recognition requirements in IFRS and US GAAP, respectively. The Boards' goal in the joint deliberations was to develop new revenue standards that:[5]

- Remove inconsistencies and weaknesses in the legacy revenue recognition literature
- Provide a more robust framework for addressing revenue recognition issues
- Improve comparability of revenue recognition practices across industries, entities within those industries, jurisdictions and capital markets
- Reduce the complexity of applying revenue recognition requirements by reducing the volume of the relevant standards and interpretations
- Provide more useful information to users through expanded disclosure requirements

The standards provide accounting requirements for all revenue arising from contracts with customers. They affect all entities that enter into contracts to provide goods or services to their customers, unless the contracts are in the scope of other IFRSs or US GAAP requirements, such as those for leases. The standards also specify the accounting for costs an entity incurs to obtain and fulfil a contract to provide goods or services to customers (see section 9.3) and provide a model for the measurement and recognition of gains and losses on the sale of certain non-financial assets, such as property, plant or equipment (see section 2.2.1).

IFRS 15 replaced all of the legacy revenue standards and interpretations in IFRS, including IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IFRIC 13 *Customer Loyalty Programmes*, IFRIC 15 *Agreements for the Construction of Real Estate*, IFRIC 18 *Transfers of Assets from Customers* and SIC-31 *Revenue – Barter Transactions Involving Advertising Services* (legacy revenue requirements or legacy IFRS).[6]

IFRS 15 became effective for annual reporting periods beginning on or after 1 January 2018. Early adoption was permitted, provided that fact was disclosed.

IFRS 15 required retrospective application. However, it allowed either a 'full retrospective' adoption (in which the standard was applied retrospectively to all of the periods presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) or a 'modified retrospective' adoption (in which the standard was applied retrospectively to only the most current period presented in the financial statements). Under both transition methods, the IASB granted transition practical expedients to provide relief.

Depending on the manner in which an entity elected to transition to IFRS 15, it may not have needed to apply the standard to contracts if they had completed performance before the date of initial application or the beginning of the earliest period presented (depending on the practical expedient and the transition method), even if they had not yet received the consideration and that consideration was still subject to variability. Applying a completed contract practical expedient might also have affected an entity's revenue recognition in

[5] IFRS 15 (2016).IN5.
[6] IFRS 15.C10.

subsequent reporting periods. That is, if an entity applied a practical expedient for completed contracts, it continued to apply its legacy revenue policy to its completed contracts, instead of IFRS 15. In some cases, even though an entity will have fully transferred its identified goods or services, there may still be revenue to recognise in accordance with its legacy revenue policy in reporting periods after adoption of IFRS 15. After issuing the standards, the Boards issued converged amendments on certain topics (e.g., principal versus agent considerations) and different amendments on other topics (e.g., licences of intellectual property). The FASB also issued several amendments that the IASB has not issued (e.g., non-cash consideration, consideration payable). See Appendix F for a discussion of the changes to the standards since issuance.

While we address the significant differences between the IASB's final standard and the FASB's final standard throughout this publication, the primary purpose of this publication is to describe the IASB's standard, including all amendments to date, and focus on the effects for IFRS preparers.[7] As such, we generally refer to the 'standard' in the singular.

FASB differences

The FASB's standard became effective for public entities, as defined, for annual reporting periods beginning after 15 December 2017 and interim periods therein.[8] Non-public entities (i.e., an entity that does not meet the definition of a public entity in the FASB's standard) were required to adopt the standard for annual reporting periods beginning after 15 December 2018 and for interim periods within annual reporting periods beginning after 15 December 2019. That is, non-public entities were not required to apply the standard in interim periods in the year of adoption.

However, in June 2020, the FASB deferred by one year the effective date for entities that had not yet issued financial statements or made financial statements available for issuance that reflected the standard as of 3 June 2020 (i.e., certain non-public and not-for-profit entities). These entities are now required to adopt the standard for annual reporting periods beginning after 15 December 2019 and interim periods within annual reporting periods beginning after 15 December 2020. Early adoption is permitted.

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7 For more information on the effect of the new revenue standard for US GAAP preparers, refer to our *Financial Reporting Developments: Revenue from contracts with customers (ASC 606)*, Revised October 2020, available on EY AccountingLink.

8 The FASB's standard defines a public entity as one of the following: A public business entity (as defined); A not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market; An employee benefit plan that files or furnishes financial statements with the US SEC. An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. The SEC staff said it would not object if these entities adopt the new revenue standard using the effective date for non-public entities rather than the effective date for public entities.

1.1 Core principle of the standard

The standard describes the principles an entity must apply to measure and recognise revenue and the related cash flows.[9] The core principle is that an entity recognises revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to a customer.[10]

The principles in IFRS 15 are applied using the following five steps:

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognise revenue when (or as) the entity satisfies a performance obligation

Entities need to exercise judgement when considering the terms of the contract(s) and all of the facts and circumstances, including implied contract terms. Entities also have to apply the requirements of the standard consistently to contracts with similar characteristics and in similar circumstances.[11] To assist entities, IFRS 15 includes detailed application guidance. The IASB also published more than 60 illustrative examples that accompany IFRS 15. We list these examples in Appendix B to this publication and provide references to where certain examples are included in this publication.

[9] IFRS 15.1.
[10] IFRS 15.2.
[11] IFRS 15.3.

2. Scope

2.1 Scope of IFRS 15 (updated October 2020)

IFRS 15 applies to all entities and all contracts with customers to provide goods or services in the ordinary course of business, except for the following contracts, which are specifically excluded:[12]

- Lease contracts within the scope of IFRS 16 *Leases*
- Insurance contracts within the scope of IFRS 4 *Insurance Contracts* (or, when effective, contracts within the scope of IFRS 17 *Insurance Contracts*, except when an entity elects to apply IFRS 15 to certain service contracts in accordance with IFRS 17.8*)*
- Financial instruments and other contractual rights or obligations within the scope of IFRS 9 *Financial Instruments*,[13] IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*
- Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers

Arrangements must meet the criteria set out in IFRS 15.9, which are discussed in section 3.1, to be accounted for as a revenue contract under the standard.

For certain arrangements, entities have to evaluate their relationship with the counterparty to the contract in order to determine whether a vendor-customer relationship exists. Some collaboration arrangements, for example, are more akin to a partnership, while others have a vendor-customer relationship. Only transactions that are determined to be with a customer are within the scope of IFRS 15.[14] The definition of a customer is discussed in section 2.3. See section 2.4 for a discussion on collaborative arrangements.

The interaction between IFRS 15 and other standards can be challenging and may require significant judgement. Such interactions with IFRS 15 include when:

- An entity needs to apply other standards' requirements to assets and liabilities arising from a revenue contract (e.g., applying certain requirements in IFRS 9 to contract assets, determining an entity's right to consideration becomes unconditional (i.e., a receivable) such that IFRS 9 applies to that asset instead of IFRS 15, see section 10.1 for further discussion)
- Other standards refer to guidance in IFRS 15 (e.g., the accounting for disposals of certain non-financial assets (as discussed in section 2.2.1), applying requirements in IFRS 15 to service concession arrangements that are within the scope of IFRIC 12 *Service Concesssion Arrangements*)
- Two or more contracts need to be assessed together to determine the appropriate standard(s) to apply (e.g., sales with repurchase agreements (see section 7.3), sale and leaseback arrangements within the scope of

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12 IFRS 15.5.

13 IFRS 9 became effective for annual periods beginning on or after 1 January 2018, superseding IAS 39 *Financial Instruments: Recognition and Measurement*. However, entities that are applying IFRS 4, have an optional temporary exemption that permits an insurance company whose activities are predominantly connected with insurance to defer adoption of IFRS 9. If an entity uses this optional exemption, it continues to apply IAS 39 until it first applies IFRS 17. IFRS 17 is effective for annual periods beginning on or after 1 January 2023. References to IFRS 9 in this publication are generally also relevant for IAS 39.

14 IFRS 15.6.

IFRS 16) or the legal form of the arrangement is not consistent with the substance. When developing IFRS 16, the IASB noted that constituents had questions about how to distinguish between a lease and a sale or purchase when legal title to the underlying asset is not transferred.[15] If an arrangement does not meet the definition of a lease because the 'lessor' has a substantive right to substitute the underlying asset throughout the period of use and, hence, is out of scope of IFRS 16, that entity may be providing a service within the scope of IFRS 15. The IASB decided not to provide guidance in this area and noted that the accounting for such leases would be similar to the sale or purchase of the respective asset and that the accounting also depends on the substance of the transaction and not its legal form.[16] Refer to our publication, *Applying IFRS: A closer look at IFRS 16 Leases*, for more information on IFRS 16.[17]

- A contract falls within the scope of more than one standard (e.g., lease with a non-lease revenue component, a contract that includes the issuance of a financial instrument and a revenue component within the scope of IFRS 15). When entities enter into transactions that are partially within the scope of IFRS 15 and partially within the scope of other standards, the standard requires an entity to apply any separation and/or measurement requirements in the other standard first, before applying the requirements in IFRS 15. See section 2.5 for further discussion.

As noted above, when effective, IFRS 17 could change the applicable standard for certain service contracts, specifically fixed-fee service contracts, which are contracts in which the level of service depends on an uncertain event. Examples include roadside assistance programmes and maintenance contracts in which the service provider agrees to repair specified equipment after a malfunction for a fixed fee. IFRS 17 indicates that these are insurance contracts and, therefore, when it is effective, that standard would apply. However, if their primary purpose is the provision of services for a fixed fee, IFRS 17 permits entities the choice of applying IFRS 15 instead of IFRS 17 to such contracts if, and only if, all of the following conditions are met:

- The entity does not reflect an assessment of the risk associated with an individual customer in setting the price of the contract with that customer
- The contract compensates the customer by providing services, rather than by making cash payments to the customer

  And

- The insurance risk transferred by the contract arises primarily from the customer's use of services rather than from uncertainty over the cost of those services[18]

The entity may make that choice on a contract-by-contract basis, but the choice for each contract is irrevocable.

2.1.1 Non-monetary exchanges (updated September 2019)

IFRS 15 does not apply to non-monetary exchanges between entities in the same line of business to facilitate sales to (potential) customers. For example, the standard does not apply to a contract between two oil companies that swap oil to fulfil demand from their respective customers in different locations on a timely basis and to reduce transportation costs. This scope exclusion applies

[15] IFRS 16.BC79.
[16] IFRS 16.BC138-BC139.
[17] Available on ey.com/IFRS.
[18] IFRS 17.8.

even though the party exchanging goods or services with the entity might meet the definition of a customer on the basis that it has contracted with the entity to obtain an output of the entity's ordinary activities. As discussed in the Basis for Conclusions, this type of scenario may be common in industries with homogeneous products.[19] Not all non-monetary exchanges between entities are outside the scope of IFRS 15 and the standard does provide requirements for contracts involving non-cash consideration in exchange for goods or services (see section 5.6 on non-cash consideration and section 5.6.2 on barter transactions). Therefore, determining whether an exchange is to facilitate a sale to a customer may require judgement. Judgement may also be needed to determine whether entities are in the same line of business.

The following examples illustrate some of these considerations:

Illustration 2-1 — Non-monetary exchange outside the scope of IFRS 15

An automobile dealer exchanges new model automobiles with another dealer to obtain the colour ordered by a customer. This non-monetary exchange is intended to facilitate a sale to a customer who is not a party to the exchange. In addition, it involves the exchange of inventory that both dealers hold for sale in the same line of business. Accordingly, this transaction is outside the scope of IFRS 15.

Illustration 2-2 — Non-monetary exchange in the scope of IFRS 15

An office supply retailer provides office equipment and supplies to an automobile dealer in exchange for an automobile. The automobile dealer will use the office equipment and supplies in its financing department. The new equipment is an upgrade from the automobile dealer's old equipment and will allow the automobile dealer to reduce administrative expenses. The office supply retailer will use the car received in its repair department, allowing the department to reduce response times and meet service level commitments. Although the exchange involves inventory held for sale by each entity, the transaction is not an exchange of a product held for sale in the ordinary course of business for a product to be sold in the same line of business to facilitate sales to customers. Accordingly, this transaction is within the scope of IFRS 15 for each entity.

[19] IFRS 15.BC58.

2.2 Other scope considerations

Certain arrangements executed by entities include repurchase provisions, either as a component of a sales contract or as a separate contract that relates to the same or similar goods in the original agreement. The form of the repurchase agreement and whether the customer obtains control of the asset will determine whether the agreement is within the scope of the standard. See section 7.3 for a discussion on repurchase agreements.

IFRS 15 also specifies the accounting for certain costs, such as the incremental costs of obtaining a contract and the costs of fulfilling a contract. However, the standard is clear that these requirements only apply if there are no other applicable requirements in IFRS for those costs.[20] See section 9.3 for further discussion on the requirements relating to contract costs in the standard.

Certain requirements in IFRS 15 are also relevant for the recognition and measurement of a gain or loss on the disposal of a non-financial asset not in the ordinary course of business (see section 2.2.1 and see section 2.3 for further discussion on determining whether a transaction is part of an entity's ordinary activities).

2.2.1 Disposal of non-financial assets not in the ordinary course of business (updated October 2018)

When an entity disposes of an asset that is within the scope of IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets* and IAS 40 *Investment Property*, and that disposal is not part of the entity's ordinary activities, the transaction is within the scope of those standards, not IFRS 15. However, IAS 16, IAS 38 and IAS 40 require entities to use certain of the requirements of IFRS 15 when recognising and measuring gains or losses arising from the sale or disposal of non-financial assets.

IAS 16, IAS 38 and IAS 40 require that the gain or loss arising from the disposal of a non-financial asset be included in profit or loss when the item is derecognised, unless IFRS 16 requires otherwise on a sale and leaseback. IAS 16 and IAS 38 specifically prohibit classification of any such gain as revenue.[21] This was reiterated by the IFRS IC in June 2020 in relation to the presentation of player transfer payments resulting from the sale of an intangible asset within the scope of IAS 38.[22] However, as an exception, IAS 16 requires entities that are in the business of renting and subsequently selling the same assets, to recognise the proceeds from the sale of such assets as revenue in accordance with IFRS 15. In this specific situation, the IASB agreed that the presentation of (gross) revenue, rather than a net gain or loss on the sale of the assets, would better reflect the ordinary activities of such entities.[23] IFRS 16 applies to disposal via a sale and leaseback.[24]

The gain or loss on disposal of a non-financial asset is the difference between the net disposal proceeds, if any, and the carrying amount of the item.[25] Under IAS 16 or IAS 38, if an entity applies the revaluation model for measurement after initial recognition, any revaluation surplus relating to the asset disposed of is transferred within equity to retained earnings when the asset is derecognised and not reflected in profit or loss.[26]

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[20] IFRS 15.8.
[21] IAS 16.68, IAS 38.113, IAS 40.69.
[22] *IFRIC Update*, June 2020.
[23] IAS 16.68A, BC35C.
[24] IAS 16.69, IAS 38.114, IAS 40.67.
[25] IAS 16.71, IAS 38.113, IAS 40.69.
[26] IAS 16.41, IAS 38.87.

As noted above, IAS 16, IAS 38 and IAS 40 provide a consistent model for the measurement and recognition of gains or losses on the sale or disposal of non-financial assets to non-customers (i.e., not in the ordinary course of business) by referring to the requirements in IFRS 15. For sales of non-financial assets to non-customers, IAS 16, IAS 38 and IAS 40 require entities to:

- Determine the date of disposal (and, therefore, derecognition of the asset) using the requirements in IFRS 15 for determining when a performance obligation is satisfied (i.e., Step 5 requirements, see section 7).[27]
- Measure the consideration that is included in the calculation of the gain or loss on disposal in accordance with the requirements for determining the transaction price (i.e., Step 3 requirements, see section 5). Any subsequent changes to the estimate of the consideration (e.g., updates of variable consideration estimates, including reassessment of the constraint) are recognised in accordance with the requirements for changes in the transaction price.[28] For example, if variable consideration is constrained at the time of disposal, it would not be recognised in profit or loss until it is no longer constrained, which could be in a subsequent period.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* provides additional requirements for assets that meet that standard's criteria to be classified as held for sale. These requirements include measurement provisions, which may affect the measurement of the amount of the subsequent gain or loss on disposal.

IFRS 10 specifies how a parent accounts for the full or partial disposal of a subsidiary.[29] The accounting treatment may, therefore, differ depending on whether a non-financial asset is sold on its own (in which case, IAS 16, IAS 38 or IAS 40 would apply) or included within a full or partial disposal of a subsidiary (in which case, IFRS 10 would apply). Where there is a retained interest in a former subsidiary, other IFRSs (such as IAS 28, IFRS 11 or IFRS 9) may also apply in accounting for the transaction.

Similar considerations may apply to disposals of non-financial assets held in a corporate wrapper that are in the ordinary course of business, since IFRS 15 excludes transactions within the scope of IFRS 10. See Question 2-11 in section 2.5 for further discussion.

[27] IAS 16.69, IAS 38.114, IAS 40.67.
[28] IAS 16.72, IAS 38.116, IAS 40.70.
[29] IFRS 10.25-26 apply if a parent loses control of a subsidiary. IFRS 10.23-24 apply if a parent's ownership interest in a subsidiary changes without the parent losing control of that subsidiary.

FASB differences

The FASB's ASC 610-20, *Other Income – Gains and Losses from Derecognition of Nonfinancial Assets*, provides guidance on how to account for any gain or loss resulting from the sale of non-financial assets or in-substance non-financial assets that are not an output of an entity's ordinary activities and are not a business. This includes the sale of intangible assets and property, plant and equipment, including real estate, as well as materials and supplies. ASC 610-20 requires entities to apply certain recognition and measurement principles of ASC 606. Thus, under US GAAP, the accounting for a contract that includes the sale of a non-financial asset to a non-customer will generally be consistent with a contract to sell a non-financial asset to a customer, except for financial statement presentation and disclosure. Sales or transfers of businesses or subsidiaries that do not contain solely non-financial assets and in-substance non-financial assets to non-customers are accounted for using the deconsolidation guidance in ASC 810, *Consolidation*.

As discussed above, IAS 16, IAS 38 and IAS 40 require entities to use certain of the requirements of IFRS 15 when recognising and measuring gains or losses arising from the sale or disposal of non-financial assets when it is not in the ordinary course of business. Changes in a parent's ownership interest in a subsidiary (including loss of control through sale or disposal) are generally accounted for under IFRS 10 (see Question 2-11). Unlike US GAAP, IFRS does not contain specific requirements regarding the sale of in-substance non-financial assets.

2.3 Definition of a customer

The standard defines a customer "as a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration".[30] IFRS 15 does not define the term 'ordinary activities' because it was derived from the definitions of revenue in the respective conceptual frameworks of the IASB and the FASB in effect when the standards were developed. In particular, the description of revenue in the IASB's *Conceptual Framework for Financial Reporting* at that time referred specifically to the 'ordinary activities' of an entity and the definition of revenue in the FASB's Statement of Financial Accounting Concepts No. 6 refers to the notion of an entity's 'ongoing major or central operations'.[31] In many transactions, a customer is easily identifiable. However, in transactions involving multiple parties, it may be less clear which counterparties are customers of the entity. For some arrangements, multiple parties could all be considered customers of the entity. However, for other arrangements, only some of the parties involved are considered customers.

During the coronavirus pandemic, governments often granted additional and wide-ranging assistance, particularly during periods involving restrictions on business activities. Identifying whether there is vendor-customer relationship may be challenging if the counterparty is the government or a similar body. To determine the appropriate standard to apply, an entity needs to consider all relevant facts and circumstances to understand whether there is an exchange transaction arising from a vendor-customer relationship (to which IFRS 15 applies) or if, for example, the entity is receiving government assistance or a grant (as defined in IAS 20 *Accounting for Government Grants and Disclosure of*

[30] IFRS 15 Appendix A.
[31] IFRS, 2010 *Conceptual Framework for Financial Reporting*, paragraph 4.29; US GAAP, *Statement of Financial Accounting Concepts No. 6*, paragraph 78.

Government Assistance). Factors to consider would include, but not be limited to, whether the government (or similar body) is providing assistance to the entity or to its customer (e.g., by paying the entity on a customer's behalf), and whether the government (or similar body) is providing assistance in their capacity as the government (or similar body) or as the entity's customer. An entity with an existing vendor-customer relationship with a government or similar body also needs to evaluate whether any additional assistance is a modification of a customer contract under IFRS 15. See section 3.4 for contract modifications.

The illustration below shows how the party considered to be the customer may differ, depending on the specific facts and circumstances:

Illustration 2-3 — Identification of a customer

An entity provides internet-based advertising services to companies. As part of those services, the entity purchases banner-space on various websites from a selection of publishers. For certain contracts, the entity provides a sophisticated service of matching the ad placement with the pre-identified criteria of the advertising party (i.e., the customer). In addition, the entity pre-purchases the banner-space from the publishers before it finds advertisers for that space. Assume that the entity appropriately concludes it is acting as the principal in these contracts (see section 4.4 for further discussion on principal versus agent considerations). Accordingly, the entity identifies that its customer is the advertiser to whom it is providing services.

In other contracts, the entity simply matches advertisers with the publishers in its portfolio, but the entity does not provide any sophisticated ad-targeting services or purchase the advertising space from the publishers before it finds advertisers for that space. Assume that the entity appropriately concludes it is acting as the agent in these contracts. Accordingly, the entity identifies that its customer is the publisher to whom it is providing services.

In addition, the identification of the performance obligations in a contract (discussed further in section 4) can have a significant effect on the determination of which party is the entity's customer. Also see the discussion of the identification of an entity's customer when applying the application guidance on consideration paid or payable to a customer in section 5.7.

2.4 Collaborative arrangements

Entities often enter into collaborative arrangements to, for example, jointly develop and commercialise intellectual property such as a drug candidate in the life sciences industry or a motion picture in the entertainment industry). In such arrangements, a counterparty may not always be a 'customer' of the entity. Instead, the counterparty may be a collaborator or partner that shares in the risks and benefits of developing a product to be marketed. This is common in the pharmaceutical, bio-technology, oil and gas, and health care industries. However, depending on the facts and circumstances, these arrangements may also contain a vendor-customer relationship component. Such contracts could still be within the scope of IFRS 15, at least partially, if the collaborator or partner meets the definition of a customer for some, or all, aspects of the arrangement. If the collaborator or partner is not a customer, the transaction is not within the scope of IFRS 15. An example of transactions between collaborators or partners not being within the scope of IFRS 15 was discussed by the IFRS IC in March 2019; it related to the output to which an entity is entitled from a joint operation, but which the entity has not yet received and sold to its customers (see Question 2-12 in section 2.5).

The IASB decided not to provide additional application guidance for determining whether certain revenue-generating collaborative arrangements are within the scope of IFRS 15. In the Basis for Conclusions, the IASB explained that it would not be possible to provide application guidance that applies to all collaborative arrangements.[32] Therefore, the parties to such arrangements need to consider all facts and circumstances to determine whether a vendor-customer relationship exists that is subject to the standard.

However, the IASB did determine that, in some circumstances, it may be appropriate for an entity to apply the principles in IFRS 15 to collaborations or partnerships (e.g., when there are no applicable or more relevant requirements that could be applied).[33]

How we see it

Identifying the customer can be difficult, especially when multiple parties are involved in a transaction. This evaluation may require significant judgement and IFRS 15 does not provide many factors to consider.

Furthermore, transactions among partners in collaboration arrangements are not within the scope of IFRS 15. Therefore, entities need to use judgement to determine whether transactions are between partners acting in their capacity as collaborators or reflect a vendor-customer relationship.

2.5 Interaction with other standards (updated October 2020)

The standard provides requirements for arrangements partially within the scope of IFRS 15 and partially within the scope of other standards, as follows:

Extract from IFRS 15

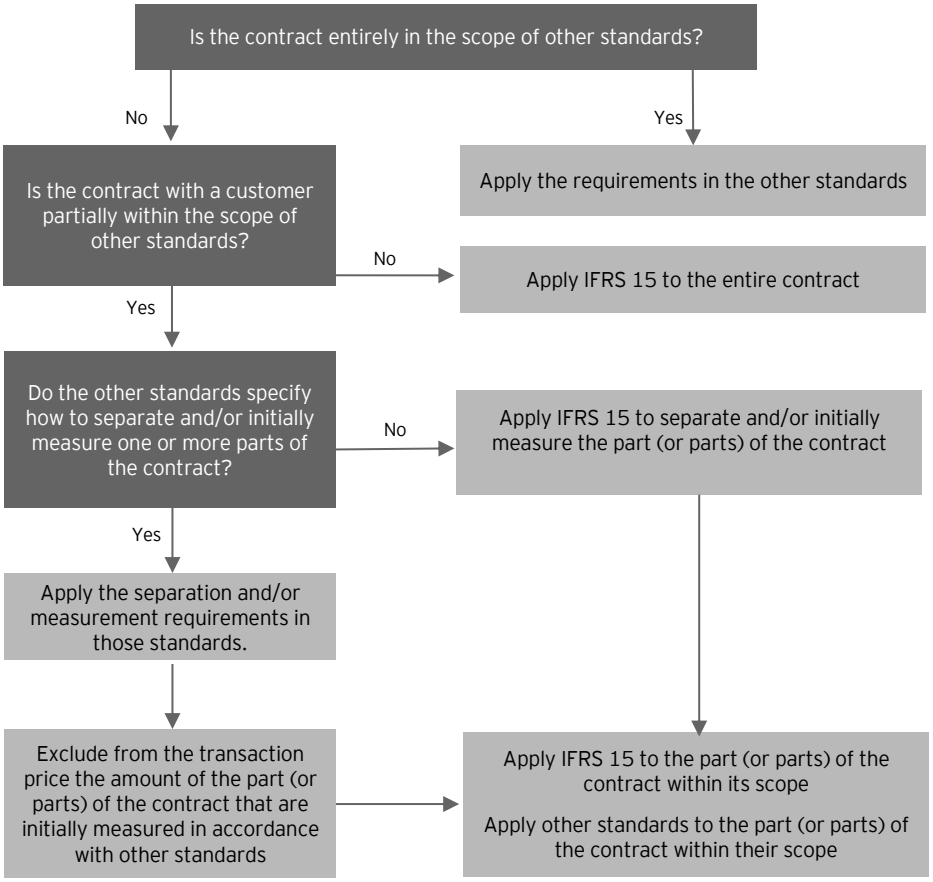
7. A contract with a customer may be partially within the scope of this Standard and partially within the scope of other Standards listed in paragraph 5.

(a) If the other Standards specify how to separate and/or initially measure one or more parts of the contract, then an entity shall first apply the separation and/or measurement requirements in those Standards. An entity shall exclude from the transaction price the amount of the part (or parts) of the contract that are initially measured in accordance with other Standards and shall apply paragraphs 73–86 to allocate the amount of the transaction price that remains (if any) to each performance obligation within the scope of this Standard and to any other parts of the contract identified by paragraph 7(b).

(b) If the other Standards do not specify how to separate and/or initially measure one or more parts of the contract, then the entity shall apply this Standard to separate and/or initially measure the part (or parts) of the contract.

[32] IFRS 15.BC54.
[33] IFRS 15.BC56.

The following chart illustrates these requirements:



If a component of the arrangement is covered by another standard or interpretation that specifies how to separate and/or initially measure that component, the entity needs to apply IFRS 15 to the remaining components of the arrangement. Some examples of where separation and/or initial measurement are addressed in other IFRS include the following:

- IFRS 9 generally requires that a financial instrument be recognised at fair value at initial recognition. For contracts that include the issuance of a financial instrument and revenue components within the scope of IFRS 15 and the financial instrument is required to be initially recognised at fair value, the fair value of the financial instrument is first measured and the remainder of the estimated contract consideration is allocated among the other components in the contract in accordance with IFRS 15.
- A contract may contain a lease coupled with an agreement to sell other goods or services (e.g., subject to IFRS 15). IFRS 16 requires that a lessor accounts separately for the lease component (in accordance with IFRS 16) and any non-lease components (in accordance with other standards) and provides application guidance on separating the components of such a contract.[34] A lessor allocates the consideration in a contract that contains a lease component and one or more additional lease or non-lease components by applying the requirements in IFRS 15 for allocating the transaction price to performance obligations and changes in the transaction price after contract inception (see section 6).[35] Care may be needed in such an allocation if the lease term (under IFRS 16) and the contract

[34] IFRS 16.12, B32-B33.
[35] IFRS 16.17.

duration (under IFRS 15) differ. Refer to our publication, *Applying IFRS: A closer look at IFRS 16 Leases*, for more information on IFRS 16.[36]

Conversely, if a component of the arrangement is covered by another standard or interpretation, but that standard or interpretation does not specify how to separate and/or initially measure that component, the entity needs to apply IFRS 15 to separate and/or initially measure each component. For example, specific requirements do not exist for the separation and measurement of the different parts of an arrangement when an entity sells a business and also enters into a long-term supply agreement with the other party. See section 6.6 for further discussion on the effect on the allocation of arrangement consideration when an arrangement includes both revenue and non-revenue components.

Frequently asked questions

Question 2-1: Before applying the financial instruments standards, are deferred-payment transactions that are part of Sharia-compliant instruments and transactions within the scope of the revenue standard? [TRG meeting 26 January 2015 – Agenda paper no. 17]

Islamic financial institutions (IFIs) enter into Sharia-compliant instruments and transactions that do not result in IFIs earning interest on loans. Instead, these transactions involve purchases and sales of real assets (e.g., vehicles) on which IFIs can earn a premium to compensate them for deferred payment terms. Typically, an IFI makes a cash purchase of the underlying asset, takes legal possession, even if only for a short time, and immediately sells the asset on deferred payment terms. The financial instruments created by these transactions are within the scope of the financial instruments standards.

At the January 2015 TRG meeting, IASB TRG members discussed whether (before applying the financial instruments standards) deferred-payment transactions that are part of Sharia-compliant instruments and transactions are within the scope of IFRS 15. IASB TRG members generally agreed that Sharia-compliant instruments and transactions may be outside the scope of the standard. However, the analysis depends on the specific facts and circumstances. This may require significant judgement as contracts often differ within and between jurisdictions. FASB TRG members did not discuss this issue.

[36] Available on ey.com/IFRS.

Frequently asked questions (cont'd)

Question 2-2: Are certain fee-generating activities of financial institutions in the scope of the revenue standard (i.e., servicing and sub-servicing financial assets, providing financial guarantees and providing deposit-related services)? [FASB TRG meeting 18 April 2016 – Agenda paper no. 52]

FASB TRG members generally agreed that the standard provides a framework for determining whether certain contracts are in the scope of the FASB's standard, ASC 606, or other standards. As discussed above, the standard's scope includes all contracts with customers to provide goods or services in the ordinary course of business, except for contracts with customers that are within the scope of certain other ASC topics that are listed as scope exclusions. If another standard specifies the accounting for the consideration (e.g., a fee) received in the arrangement, the consideration is outside the scope of ASC 606. If other standards do not specify the accounting for the consideration and there is a separate good or service provided, the consideration is in (or at least partially in) the scope of ASC 606. The FASB staff applied this framework in the TRG agenda paper to arrangements to service financial assets, provide financial guarantees and provide deposit-related services.

FASB TRG members generally agreed that income from servicing financial assets (e.g., loans) is not within the scope of ASC 606. An asset servicer performs various services, such as communication with the borrower and payment collection, in exchange for a fee. FASB TRG members generally agreed that an entity should look to ASC 860, *Transfers and Servicing*, to determine the appropriate accounting for these fees. This is because ASC 606 contains a scope exception for contracts that fall under ASC 860, which provides requirements on the recognition of the fees (despite not providing explicit requirements on revenue accounting).

FASB TRG members generally agreed that fees from providing financial guarantees are not within the scope of ASC 606. A financial institution may receive a fee for providing a guarantee of a loan. These types of financial guarantees are generally within the scope of ASC 460, *Guarantees* or ASC 815, *Derivatives and Hedging*. FASB TRG members generally agreed that an entity should look to ASC 460 or ASC 815 to determine the appropriate accounting for these fees. This is because ASC 606 contains a scope exception for contracts that fall within those topics, which provide principles an entity can follow to determine the appropriate accounting to reflect the financial guarantor's release from risk (and credit to earnings).

FASB TRG members also generally agreed that fees from deposit-related services are within the scope of ASC 606. In contrast to the decisions for servicing income and financial guarantees, the guidance in ASC 405, *Liabilities*, that financial institutions apply to determine the appropriate liability accounting for customer deposits, does not provide a model for recognising fees related to customer deposits (e.g., ATM fees, account maintenance or dormancy fees). Accordingly, FASB TRG members generally agreed that deposit fees and charges are within the scope of ASC 606, even though ASC 405 is listed as a scope exception in ASC 606, because of the lack of guidance on the accounting for these fees in ASC 405.

It should be noted that, while this was not specifically discussed by the IASB TRG, IFRS preparers may find the FASB TRG's discussions helpful in assessing whether certain contracts are within the scope of IFRS 15 or other standards.

Frequently asked questions (cont'd)

Question 2-3: Are credit card fees in the scope of the FASB's revenue standard? [TRG meeting 13 July 2015 – Agenda paper no. 36]

A bank that issues credit cards can have various income streams (e.g., annual fees) from a cardholder under various credit card arrangements. Some of these fees may entitle cardholders to ancillary services (e.g., concierge services, airport lounge access). The card issuer may also provide rewards to cardholders based on their purchases. US GAAP stakeholders had questioned whether such fees and programmes are within the scope of the revenue standard, particularly when a good or service is provided to a cardholder.

While this question was only raised by US GAAP stakeholders, IASB TRG members generally agreed that an IFRS preparer first needs to determine whether the credit card fees are within the scope of IFRS 9. IFRS 9 requires that any fees that are an integral part of the effective interest rate for a financial instrument be treated as an adjustment to the effective interest rate. Conversely, any fees that are not an integral part of the effective interest rate of the financial instrument are generally accounted for under IFRS 15.

FASB TRG members generally agreed that credit card fees that are accounted for under ASC 310, *Receivables* are not in the scope of ASC 606. This includes annual fees that may entitle cardholders to ancillary services. FASB TRG members noted that this conclusion is consistent with legacy US GAAP requirements for credit card fees. However, the observer from the US SEC noted that the nature of the arrangement must truly be that of a credit card lending arrangement in order to be in the scope of ASC 310. As such, entities need to continue evaluating their arrangements as new programmes develop. Credit card fees could, therefore, be treated differently under IFRS and US GAAP.

Question 2-4: Are credit cardholder rewards programmes in the scope of the FASB's revenue standard? [TRG meeting 13 July 2015 – Agenda paper no. 36]

FASB TRG members generally agreed that if all consideration (i.e., credit card fees discussed in Question 2-3 above) related to the rewards programme is determined to be within the scope of ASC 310, the rewards programme is not in the scope of ASC 606. However, this determination has to be made based on the facts and circumstances due to the wide variety of credit card reward programmes offered. IASB TRG members did not discuss this issue because the question was only raised in relation to US GAAP.

Question 2-5: Are contributions (as defined in US GAAP) in the scope of the FASB's revenue standard? [TRG meeting 30 March 2015 – Agenda paper no. 26]

The FASB amended ASC 606 to clarify that an entity needs to consider the requirements in ASC 958-605, *Not-for-Profit Entities – Revenue Recognition* when determining whether a transaction is a contribution (as defined in the ASC Master Glossary) within the scope of ASC 958-605 or a transaction

Frequently asked questions (cont'd)

within the scope of ASC 606.[37] The requirements for contributions received in ASC 958-605 generally apply to all entities that receive contributions (i.e., not just not-for-profit entities), unless otherwise indicated.

Before the amendment, FASB TRG members discussed this issue and generally agreed that contributions are not within the scope of ASC 606 because they are non-reciprocal transfers. That is, contributions generally do not represent consideration given in exchange for goods or services that are an output of the entity's ordinary activities. IASB TRG members did not discuss this issue because the question was only raised in the context of US GAAP.

Question 2-6: Are fixed-odds wagering contracts within the scope of the revenue standard?

In fixed-odds wagering contracts, the payout for wagers placed on gambling activities (e.g., table games, slot machines, sports betting) is known at the time the wager is placed.

Under IFRS, consistent with a July 2007 IFRS Interpretations Committee (IFRS IC) agenda decision, wagers that meet the definition of a derivative are within the scope of IFRS 9. Those that do not meet the definition of a derivative are within the scope of IFRS 15.

FASB differences

Under US GAAP, the FASB added scope exceptions in ASC 815 and ASC 924, *Entertainment – Casinos*, in December 2016 to clarify that fixed-odds wagering arrangements are within the scope of ASC 606.

Question 2-7: Are pre-production activities related to long-term supply arrangements in the scope of the revenue standard?

In some long-term supply arrangements, entities perform upfront engineering and design activities to create new technology or adapt existing technology according to the needs of the customer. These pre-production activities are often a prerequisite to delivering any units under a production contract.

Entities need to evaluate whether the pre-production activities are promises in a contract with a customer (and potentially performance obligations) under IFRS 15. When making this evaluation, entities need to determine whether the activities transfer a good or service to a customer. Refer to Question 4-1 in section 4.1.1 for further discussion on determining whether pre-production activities are promised goods or services under IFRS 15. If an entity determines that these activities are promised goods or services, it will apply the requirements in IFRS 15 to those goods or services.

[37] ASU 2018-08, *Accounting Standards Update 2018-08—Not-For-Profit Entities (Topic 958): Clarifying The Scope And Accounting Guidance For Contributions Received And Contributions Made*.

Frequently asked questions (cont'd)

Question 2-8: Are sales of by-products or scrap materials in the scope of the revenue standard?

Consider an example in which a consumer products entity sells by-products or accumulated scrap materials that are produced as a result of its manufacturing process. In determining whether the sale of by-products or scrap materials to third parties is in the scope of IFRS 15, an entity first determines whether the sale of such items is an output of the entity's ordinary activities. This is because IFRS 15 defines revenue as "income arising in the course of an entity's ordinary activities".[38] If an entity determines the sale of such items represents revenue from a contract with a customer, it would generally recognise the sale under IFRS 15.

If an entity determines that such sales are not in the course of its ordinary activities, the entity would recognise those sales separately from revenue from contracts with customers because they represent sales to non-customers.

We do not believe that it would be appropriate for an entity to recognise the sale of by-products or scrap materials as a reduction of cost of goods sold. This is because recognising the sale of by-products or scrap materials as a reduction of cost of goods sold may inappropriately reflect the cost of raw materials used in manufacturing the main product. However, this interpretation would not apply if other accounting standards allow for recognition as a reduction of costs.

IAS 2 *Inventories* requires that the costs of conversion of the main product and the by-product be allocated between the products on a rational and consistent basis. However, IAS 2 mentions that most by-products, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.[39] We believe that the language in IAS 2 only relates to the allocation of the costs of conversion between the main product and by-product and does not allow the proceeds from the sale of by-products to be presented as a reduction of cost of goods sold.

Question 2-9 Are the sales of prepaid gift cards within the scope of IFRS 15?

Entities may sell prepaid gift cards in their normal course of business in exchange for cash. The prepaid gift cards typically provide the customer with the right to redeem those cards in the future for goods or services of the entity and/or third parties. For any unused balance of the prepaid gift cards, entities need to recognise a liability that will be released upon redemption of that unused balance. However, the features of each prepaid gift card may vary and the nature of the liability depends on the assessment of these features. Entities may need to use judgement in order to determine whether the prepaid gift card is within the scope of IFRS 15 or another standard.

[38] IFRS 15 Appendix A.
[39] IAS 2.14.

Frequently asked questions (cont'd)

Prepaid gift cards that give rise to financial liabilities are within the scope of IFRS 9. If a prepaid gift card does not give rise to a financial liability is likely to be within the scope of IFRS 15. For further information on applying IFRS 15 to prepaid gift cards within its scope, refer to section 7.9.

An example of a prepaid gift card that is within the scope of IFRS 9 was discussed by the IFRS IC at its March 2016 meeting. The issue related to the accounting treatment of any unused balance on a prepaid card issued by an entity in exchange for cash as well as the classification of the relevant liability that arises. The discussion was limited to prepaid cards that have the specific features described in the request to the IFRS IC. In particular, the prepaid card:[40]

a. Has no expiry date and no back-end fees. That is, any unspent balance does not reduce unless it is spent by the cardholder

b. Is non-refundable, non-redeemable and non-exchangeable for cash

c. Can be redeemed only for goods or services to a specified monetary amount

   And

d. Can be redeemed only at specified third-party merchants (the range of merchants accepting the specific card could vary depending on the card programme) and, upon redemption, the entity delivers cash to the merchant(s)

The IFRS IC observed that when an entity issues a prepaid card with the above features, it is contractually obliged to deliver cash to the merchants on behalf of the cardholder. Although this obligation is conditional upon the cardholder redeeming the card by purchasing goods or services, the entity's right to avoid delivering cash to settle this contractual obligation is not unconditional. On this basis, the IFRS IC concluded that the entity's liability for such a prepaid card meets the definition of a financial liability and would fall within the scope of IFRS 9 and IAS 32 *Financial Instruments: Presentation*. Entities may need to apply judgement to determine which standard applies depending upon the specific facts and circumstances for scenarios other than the one discussed by the IFRS IC in its March 2016 meeting. The IFRS IC also noted in its agenda decision that its discussion on this issue did not include customer loyalty programmes.

Question 2-10: How does a utility entity determine whether a contract that includes a non-refundable upfront fee received for establishing a connection to a network (i.e., a connection fee) is within the scope of IFRS 15?

See response to Question 5-31 in section 5.8.

[40] *IFRIC Update*, March 2016, available on the IASB's website.

Frequently asked questions (cont'd)

Question 2-11: Does an entity apply IFRS 10 or IFRS 15 to the sale of a corporate wrapper to a customer?

It depends. As part of their ordinary activities, entities may enter into contracts with customers to sell an asset by selling their equity interest in a separate entity (commonly referred to as a 'corporate wrapper' or 'single-asset entity') holding that asset (e.g., real estate), rather than by selling the asset itself. Entities may sell assets via a sale of equity interest in a corporate wrapper for tax or legal reasons or because of local regulation or business practice. Facts and circumstances may differ, for example, in relation to:

- When the corporate wrapper is created and the asset transferred into it
- When the entity enters into a contract with a customer
- If the asset is constructed by the entity, when construction starts
- When the equity interest in the corporate wrapper is legally transferred to the customer

In addition, a corporate wrapper could include only one asset (plus a related deferred tax asset or liability) or one or more other assets or liabilities, such as a financing liability.

Whether an entity needs to apply IFRS 10 or IFRS 15 to the sale of a corporate wrapper to a customer depends on facts and circumstances and may require significant judgement, including consideration of the following:

- IFRS 10 requires an entity that controls one or more entities (i.e., the parent) to present consolidated financial statements, with some limited exceptions, and sets out the requirements to determine whether, as an investor, it controls (and, therefore, must consolidate) an investee. A parent consolidates an entity that it controls (i.e., the subsidiary) from the date on which it first obtains control. It ceases consolidating that subsidiary on the date on which it loses control.[41] IFRS 10 also specifies how a parent accounts for the full or partial sale of a subsidiary.[42]
- IFRS 15 excludes from its scope "... financial instruments and other contractual rights or obligations within the scope of ... IFRS 10".[43]

In practice, some entities apply IFRS 15 to all such contracts with customers because the transactions are part of the entity's ordinary activities and they believe doing so would better reflect the 'substance' of each transaction (e.g., the entity is 'in substance' selling the asset and not the equity interest; the structure is for legal, tax or risk reasons and they believe it should not affect the recognition of revenue).[44]

Judgement may also be needed in determining whether an investor controls the corporate wrapper. For example, the (selling) entity may act as an agent

[41] IFRS 10.2, 4-4B, 20, Appendix A.

[42] IFRS 10.25-26 apply if a parent loses control of a subsidiary. IFRS 10.23-24 apply if a parent's ownership interest in a subsidiary changes without the parent losing control of that subsidiary.

[43] IFRS 15.5(d).

[44] IFRS IC Agenda Paper 6, *Sale of a single asset entity containing real estate (IFRS 10)*, paragraphs 15-16, June 2019, available on the IASB's website.

Frequently asked questions (cont'd)

(in accordance with IFRS 10) in relation to the corporate wrapper based on the terms and conditions in the customer contract. IFRS 10 would not apply to the sale, if the entity does not control the corporate wrapper prior to sale.

In June 2019, the IFRS IC discussed a request about the accounting for a transaction in which an entity, as part of its ordinary activities, enters into a contract with a customer to sell real estate by selling its equity interest in a subsidiary. The entity established the subsidiary some time before it enters into the contract with the customer; the subsidiary has one asset (real estate inventory) and a related tax asset or liability. The entity has applied IFRS 10 in consolidating the subsidiary before it loses control of the subsidiary as a result of the transaction with the customer. The IFRS IC discussed this issue, but did not reach any decisions at its June 2019 meeting. At the time of writing, the IFRS IC had not issued an agenda decision on this matter. Instead, the issue was referred to the IASB.

In October 2019, the IASB directed its staff to research the feasibility of narrow-scope standard setting. In June 2020, the IASB discussed a possible narrow-scope amendment that would have required an entity to apply IFRS 15, instead of IFRS 10, to sales of subsidiaries where all of the following apply:

- The entity contracts with a customer for goods or services that are the output of its ordinary activities in exchange for consideration
- The subsidiary contains only inventory and any related income tax asset or liability
- The entity retains no interest in the inventory transferred to the customer.

The Board decided against proposing this amendment.[45]

During the discussions held by both the IFRS IC and the IASB, a number of members of the Committee and the Board considered that, absent an amendment, IFRS 10 (rather than IFRS 15) would apply to the transaction considered. During the June 2020 discussion, some Board members thought there was merit in a narrow-scope amendment. However, concerns were raised about potential unintended consequences of proposing a narrow-scope amendment without a more comprehensive discussion. Any narrow-scope amendment would affect the scope of both IFRS 10 and IFRS 15 and, as such, Board members wanted to learn more from stakeholders about the need for, and the consequences of, such a project.[46] However, these considerations were not noted in the relevant *IFRIC Update* and *IASB Update* that were issued as summaries of the meetings. At the time of writing, this matter was expected to be considered as part of phase 2 of the post-implementation review (PIR) of IFRS 10, which was scheduled to commence in Q4 of 2020.[47]

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45 *IASB Update*, June 2020, available on the IASB's website and IASB agenda paper 12A, *Maintenance and Consistent Application: Sale of a Subsidiary to a Customer*, dated June 2020, available on the IASB's website.

46 Project summary: *Sale of Subsidiary to a customer*, available on the IASB's website, accessed on 27 July 2020

47 IASB work plan, available on the IASB's website, accessed on 27 July 2020

Frequently asked questions (cont'd)

Until the deliberation process on this question is completed, there may continue to be some diversity in practice. However, in the meantime, entities may need to consider the discussions on this matter as they determine the appropriate standard to apply to transactions with customers involving the loss of control of a single asset entity.

It should be noted that the applicable standard (i.e., IFRS 10 or IFRS 15) is not just a matter of presentation. That is, it may also affect, for example, the timing of recognition (i.e., point in time versus over time and, if point in time, the specific point in time) and the measurement of consideration (e.g., IFRS 10 does not constrain variable consideration). Furthermore, IFRS 10 provides specific requirements for the derecognition of all assets and liabilities of the former subsidiary on loss of control, which would not apply if the contract with the customer is within the scope of IFRS 15.

FASB differences

Under US GAAP, the sale of a corporate wrapper to a customer generally will be in the scope of ASC 606. ASC 810 indicates that its deconsolidation and derecognition guidance does not apply to a loss of control of a subsidiary that is a business if that transaction is within the scope of ASC 606. Loss of control of a subsidiary that is not a business is equally excluded from the scope of ASC 810 if the substance of the transaction is within the scope of another standard (e.g., ASC 606, ASC 610-20). Therefore, the sale of a corporate wrapper to a counterparty that is not a customer may be in the scope of ASC 610-20, which applies to the recognition of gains or losses on transfers of non-financial assets and in-substance non-financial assets, including transfers of these assets when included in a consolidated subsidiary, that are not businesses, to counterparties that are not customers.

Question 2-12: Can a joint operator under IFRS 11 recognise as revenue under IFRS 15 amounts to which it is entitled as a joint operator that have not yet been sold to customers?

No. Revenue recognised in accordance with IFRS 15 must reflect an entity's performance in transferring a good or service to a customer.

Under IFRS 11, a joint operator is required to account for revenue relating to its interest in the joint operation (as defined in IFRS 11) by applying the standards that are applicable to the particular revenue.[48] Therefore, while contracts with joint operators are excluded from the scope of IFRS 15, if revenue relating to an interest in a joint operation under IFRS 11 arises from a contract with a customer, it is recognised in accordance with IFRS 15.

As discussed in section 2.1, IFRS 15 applies only to contracts with customers. In addition, IFRS 11 requires a joint operator to recognise "its revenue from the sale of its share of the output arising from the joint operation".[49] Therefore, revenue recognised by a joint operator must depict the output

[48] IFRS 11.21.
[49] IFRS 11.20(c).

Frequently asked questions (cont'd)

it has received from the joint operation and sold to customers, rather than the production of output or entitlement to output, as shown in the example below.

This is consistent with the conclusion reached by the IFRS IC in March 2019. The IFRS IC discussed this issue using the following example:[50]

Example of interaction between IFRS 11 and IFRS 15 in recognising revenue relating to an interest in a joint operation

Operators A and B establish an unincorporated joint operation (JO) that they expect will produce output over a 2-year period. According to the joint operating agreement, each operator is entitled to receive 50% of the output arising from the JO's activities and obliged to pay for 50% of the production costs incurred. For operational reasons, the output received by each joint operator and transferred to its customers in any one reporting period is different from the output to which it is entitled. Any difference between the operators' entitlement and the output received will be settled through future deliveries of output arising from the JO, not in cash.

Output from the JO's activities was CU100 in year 1 and CU150 in year 2. In Years 1 and 2, both operators paid for 50% of the production costs incurred.

	Operator A	Operator B
Year 1		
Entitlement to output	CU50	CU50
Output received and transferred to customers	CU48	CU52
Asset / (liability)	CU2	(CU2)
Year 2		
Entitlement to output	CU75	CU75
Output received and transferred to customers	CU77	CU73
	-	-

Operators A and B consider whether to recognise as revenue in each period: the entitlement to the output produced from the joint operation's activities; or the output that was received and transferred to its customers.

In this fact pattern, the IFRS IC concluded that, in accordance with IFRS 15, each joint operator recognises revenue to depict only the transfer of output to its customers in each reporting period. As such, if Operators A and B are entitled to output, but that output has not been received and sold to customers, they do not recognise revenue.

Therefore, Operator A recognises revenue from contracts with customers of CU48 in Year 1 and CU77 in Year 2. Similarly, Operator B recognises revenue from contracts with customers of CU52 in Year 1 and CU73 in Year 2.

[50] *IFRIC Update*, March 2019, available on the IASB's website; and IFRS IC Agenda Paper 2, November 2018, available on the IASB's website.

Frequently asked questions (cont'd)

Question 2-13: Are equity instruments issued by an entity to a customer in connection with a revenue arrangement within the scope of the revenue standard?

Whether or not an entity needs to apply IFRS 15 to a transaction in which equity instruments (e.g., shares) are issued to a customer in connection with a revenue arrangement depends on the substance and purpose of the transaction.

Many entities make payments to their customers. In some cases, the consideration paid or payable represents purchases by the entity of goods or services offered by the customer that satisfy a business need of the entity. In other cases, the consideration paid or payable represents incentives given by the entity to entice the customer to purchase, or continue purchasing, its goods or services.

According to IFRS 15.7, a contract with a customer may be partially within the scope of IFRS 15 and partially within the scope of other standards. IFRS 15 does not specify whether equity instruments issued by an entity to a customer are a type of consideration paid or payable to customer. Nor does IFRS 2 *Share-based Payment* specifically address such transactions. Depending on the facts and circumstances, several standards (or a combination of standards) may be applicable (e.g., IFRS 2, IFRS 15, IAS 32). To determine the substance of the transaction and which standard(s) apply, entities will need to consider all relevant facts and circumstances, including the purpose of the transaction. Such determinations may require significant judgement.

FASB differences

In 2018, the FASB amended ASC 606 to clarify that equity instruments granted to customers in conjuction with the sale of goods or services (e.g., shares, options) are within the scope of the requirements for consideration payable to customers.[51] The IASB has not proposed any similar amendments to IFRS 15. Therefore, entities applying IFRS could reach a different accounting conclusion from those applying US GAAP.

[51] ASU 2018-07 *Compensation – Stock Compensation (718): Improvements to Nonemployee Share-Based Payment accounting*.

3. Identify the contract with the customer

To apply the five-step model in IFRS 15, an entity must first identify the contract, or contracts, to provide goods or services to customers.

A contract must create enforceable rights and obligations to fall within the scope of the model in the standard. Such contracts may be written, oral or implied by an entity's customary business practices. For example, if an entity has an established practice of starting performance based on oral agreements with its customers, it may determine that such oral agreements meet the definition of a contract.

As a result, an entity may need to account for a contract as soon as performance begins, rather than delay revenue recognition until the arrangement is documented in a signed contract. Certain arrangements may require a written contract to comply with laws or regulations in a particular jurisdiction. These requirements must be considered when determining whether a contract exists.

In the Basis for Conclusions, the Board acknowledged that entities need to look at the relevant legal framework to determine whether the contract is enforceable because factors that determine enforceability may differ among jurisdictions.[52] The Board also clarified that, while the contract must be legally enforceable to be within the scope of the model in the standard, all of the promises do not have to be enforceable to be considered performance obligations (see section 4.1). That is, a performance obligation can be based on the customer's valid expectations (e.g., due to the entity's business practice of providing an additional good or service that is not specified in the contract). In addition, the standard clarifies that some contracts may have no fixed duration and can be terminated or modified by either party at any time. Other contracts may automatically renew on a specified periodic basis. Entities are required to apply IFRS 15 to the contractual period in which the parties have present enforceable rights and obligations. Contract enforceability and termination clauses are discussed in section 3.2.

Illustration 3-1 — Oral contract

IT Support Co. provides online technology support for customers remotely via the internet. For a fixed fee, IT Support Co. will scan a customer's personal computer (PC) for viruses, optimise the PC's performance and solve any connectivity problems. When a customer calls to obtain the scan services, IT Support Co. describes the services it can provide and states the price for those services. When the customer agrees to the terms stated by the representative, payment is made over the telephone. IT Support Co. then gives the customer the information it needs to obtain the scan services (e.g., an access code for the website). It provides the services when the customer connects to the internet and logs onto the entity's website (which may be that day or a future date).

In this example, IT Support Co. and its customer are entering into an oral agreement, which is legally enforceable in this jurisdiction, for IT Support Co. to repair the customer's PC and for the customer to provide consideration by transmitting a valid credit card number and authorisation over the telephone.

[52] IFRS 15.BC32.

Illustration 3-1 — Oral contract (cont'd)
The required criteria for a contract with a customer (discussed further below) are all met. As such, this agreement is within the scope of the model in the standard at the time of the telephone conversation, even if the entity has not yet performed the scanning services.

3.1 Attributes of a contract (updated October 2018)

To help entities determine whether (and when) their arrangements with customers are contracts within the scope of the model in the standard, the Board identified certain attributes that must be present, as follows:[53]

- The parties have approved the contract and are committed to perform their respective obligations.
- Each party's rights regarding the goods or services to be transferred can be identified.
- Payment terms can be identified.
- The contract has commercial substance.
- It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

The Board noted in the Basis for Conclusions that the criteria are similar to those in previous revenue recognition requirements and in other existing standards and are important in an entity's assessment of whether the arrangement contains enforceable rights and obligations.[54]

These criteria are assessed at the inception of the arrangement. If the criteria are met at that time, an entity does not reassess these criteria unless there is an indication of a significant change in facts and circumstances.[55] For example, as noted in IFRS 15.13, if the customer's ability to pay significantly deteriorates, an entity would have to reassess whether it is probable that the entity will collect the consideration to which it is entitled in exchange for transferring the remaining goods or services under the contract. The updated assessment is prospective in nature and would not change the conclusions associated with goods or services already transferred. That is, an entity would not reverse any receivables, revenue or contract assets already recognised under the contract.[56]

If the criteria are not met (and until the criteria are met), the arrangement is not considered a revenue contract under the standard and the requirements discussed in section 3.5 must be applied.

[53] IFRS 15.9.
[54] IFRS 15.BC33.
[55] IFRS 15.13.
[56] IFRS 15.BC34.

Frequently asked questions

Question 3-1: Does a master supply arrangement (MSA) create enforceable rights and obligations to be considered a contract within the scope of the model in IFRS 15?

An entity may use an MSA to govern the overall terms and conditions of a business arrangement between itself and a customer (e.g., scope of services, pricing, payment terms, warranties and other rights and obligations). Typically, when an entity and a customer enter into an MSA, purchases are subsequently made by the customer by issuing a non-cancellable purchase order or an approved online authorisation that explicitly references the MSA and specifies the products, services and quantities to be delivered.

In such cases, the MSA is unlikely to create enforceable rights and obligations, which are needed to be considered a contract within the scope of the model in IFRS 15. This is because, while the MSA may specify the pricing or payment terms, it usually does not specify the specific goods or services, or quantities thereof, to be transferred. Therefore, each party's rights and obligations regarding the goods or services to be transferred are not identifiable. It is likely that the MSA and the customer order, taken together, would constitute a contract under IFRS 15. As such, entities need to evaluate both the MSA and the subsequent customer order(s) together to determine whether and when the criteria in IFRS 15.9 are met.

If an MSA includes an enforceable clause requiring the customer to purchase a minimum quantity of goods or services, the MSA alone may constitute a contract under the standard because enforceable rights and obligations exist for this minimum amount of goods or services.

Question 3-2: How would an entity determine whether a contract exists within the scope of the model during a free trial period?

Free trial periods are common in certain subscription arrangements (e.g., magazines, streaming services). A customer may receive a number of 'free' months of goods or services at the inception of an arrangement; before the paid subscription begins; or as a bonus period at the beginning or end of a paid subscription period.

Under IFRS 15, revenue is not recognised until an entity determines that a contract within the scope of the model exists. Once an entity determines that an IFRS 15 contract exists, it is required to identify the promises in the contract. Therefore, if the entity has transferred goods or services prior to the existence of an IFRS 15 contract, we believe that the free goods or services provided during the trial period would generally be accounted for as marketing incentives.

Consider an example in which an entity has a marketing programme to provide a three-month free trial period of its services to prospective customers. The entity's customers are not required to pay for the services provided during the free trial period and the entity is under no obligation to provide the services under the marketing programme. If a customer enters into a contract with the entity at the end of the free trial period that obliges the entity to provide services in the future (e.g., signing up for a

Frequently asked questions (cont'd)

subsequent 12-month period) and obliges the customer to pay for the services, the services provided as part of the marketing programme may not be promises that are part of an enforceable contract with the customer.

However, if an entity, as part of a negotiation with a prospective customer, agrees to provide three free months of services if the customer agrees to pay for 12 months of services (effectively providing the customer a discount on 15 months), the entity would identify the free months as promises in the contract because the contract requires it to provide them.

The above interpretation applies if the customer is not required to pay any consideration for the additional goods or services during the trial period (i.e., they are free). If the customer is required to pay consideration in exchange for the goods or services received during the trial period (even if it is only a nominal amount), a different accounting conclusion could be reached. Entities need to apply judgement to evaluate whether a contract exists that falls within the scope of the standard.

Question 3-3: Should entities consider side agreements when determining whether a contract exists within the scope of the model?

Yes, all terms and conditions that create or negate enforceable rights and obligations must be considered when determining whether a contract exists under the standard. Understanding the entire contract, including any side agreements or other amendments, is critical to this determination.

Side agreements are amendments to a contract that can be either undocumented or documented separately from the main contract. The potential for side agreements is greater for complex or material transactions or when complex arrangements or relationships exist between an entity and its customers. Side agreements may be communicated in many forms (e.g., oral agreements, email, letters or contract amendments) and may be entered into for a variety of reasons.

Side agreements may provide an incentive for a customer to enter into a contract near the end of a financial reporting period or to enter into a contract that it would not enter into in the normal course of business. Side agreements may entice a customer to accept delivery of goods or services earlier than required or may provide the customer with rights in excess of those customarily provided by the entity. For example, a side agreement may extend contractual payment terms; expand contractually stated rights; provide a right of return; or commit the entity to provide future products or functionality not contained in the contract or to assist resellers in selling a product. Therefore, if the provisions in a side agreement differ from those in the main contract, an entity should assess whether the side agreement creates new rights and obligations or changes existing rights and obligations. See sections 3.3 and 3.4, respectively, for further discussion of the standard's requirements on combining contracts and contract modifications.

3.1.1 Parties have approved the contract and are committed to perform their respective obligations

Before applying the model in IFRS 15, the parties must have approved the contract. As indicated in the Basis for Conclusions, the Board included this criterion because a contract might not be legally enforceable without the approval of both parties.[57] Furthermore, the Board decided that the form of the contract (i.e., oral, written or implied) is not determinative in assessing whether the parties have approved the contract. Instead, an entity must consider all relevant facts and circumstances when assessing whether the parties intend to be bound by the terms and conditions of the contract. In some cases, the parties to an oral or implied contract may have the intent to fulfil their respective obligations. However, in other cases, a written contract may be required before an entity can conclude that the parties have approved the arrangement.

In addition to approving the contract, the entity must be able to conclude that both parties are committed to perform their respective obligations. That is, the entity must be committed to providing the promised goods or services. In addition, the customer must be committed to purchasing those promised goods or services. In the Basis for Conclusions, the Board clarified that an entity and a customer do not always have to be committed to fulfilling all of their respective rights and obligations for a contract to meet this requirement.[58] The Board cited, as an example, a supply agreement between two parties that includes stated minimums. The customer does not always buy the required minimum quantity and the entity does not always enforce its right to require the customer to purchase the minimum quantity. In this situation, the Board stated that it may still be possible for the entity to determine that there is sufficient evidence to demonstrate that the parties are substantially committed to the contract. This criterion does not address a customer's intent and ability to pay the consideration (i.e., collectability). Collectability is a separate criterion and is discussed in section 3.1.5.

Termination clauses are also an important consideration when determining whether both parties are committed to perform under a contract and, consequently, whether a contract exists. See section 3.2 for further discussion of termination clauses and how they affect contract duration.

3.1.2 Each party's rights regarding the goods or services to be transferred can be identified

This criterion is relatively straightforward. If the goods or services to be provided in the arrangement cannot be identified, it is not possible to conclude that an entity has a contract within the scope of the model in IFRS 15. The Board indicated that if the promised goods or services cannot be identified, the entity cannot assess whether those goods or services have been transferred because the entity would be unable to assess each party's rights with respect to those goods or services.[59]

3.1.3 Payment terms can be identified

Identifying the payment terms does not require that the transaction price be fixed or stated in the contract with the customer. As long as there is an enforceable right to payment (i.e., enforceability as a matter of law) and the contract contains sufficient information to enable the entity to estimate the transaction price (see further discussion in section 5), the contract would

[57] IFRS 15.BC35.
[58] IFRS 15.BC36.
[59] IFRS 15.BC37.

qualify for accounting under the standard (assuming the remaining criteria set out in IFRS 15.9 in the extract in section 3.1 above have been met).

3.1.4 Commercial substance

The Board included a criterion that requires arrangements to have commercial substance (i.e., the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract) to prevent entities from artificially inflating revenue.[60] The model in IFRS 15 does not apply if an arrangement does not have commercial substance. Historically, some entities in high-growth industries allegedly engaged in transactions in which goods or services were transferred back and forth between the same entities in an attempt to show higher transaction volume and gross revenue (sometimes known as 'round-tripping'). This is also a risk in arrangements that involve non-cash consideration.

Determining whether a contract has commercial substance for the purposes of IFRS 15 may require significant judgement. In all situations, the entity must be able to demonstrate a substantive business purpose exists, considering the nature and structure of its transactions.

IFRS 15 does not contain requirements specific to advertising barter transactions. Entities need to carefully consider the commercial substance criterion when evaluating these types of transactions (see section 5.6.2 for further discussion on barter transactions).

3.1.5 Collectability (updated October 2020)

Under IFRS 15, collectability refers to the customer's ability and intent to pay the amount of consideration to which the entity will be entitled in exchange for the goods or services that will be transferred to the customer. An entity needs to assess a customer's ability to pay based on the customer's financial capacity and its intention to pay considering all relevant facts and circumstances, including past experiences with that customer or customer class.[61]

In the Basis for Conclusions, the Board noted that the purpose of the criteria in IFRS 15.9 is to require an entity to assess whether a contract is valid and represents a genuine transaction. The collectability criterion (i.e., determining whether the customer has the ability and the intention to pay the promised consideration) is a key part of that assessment. In addition, the Board noted that, in general, entities only enter into contracts in which it is probable that the entity will collect the amount to which it will be entitled.[62] That is, in most instances, an entity would not enter into a contract with a customer if there was significant credit risk associated with that customer without also having adequate economic protection to ensure that it would collect the consideration. The IASB expects that only a small number of arrangements may fail to meet the collectability criterion.[63]

IFRS 15.9(e) requires an entity to evaluate at contract inception whether it is *probable* that it will *collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to a customer*. An entity is also required to reassess collectability after contract inception, when

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60 IFRS 15.BC40.
61 IFRS 15.BC45.
62 IFRS 15.BC43.
63 IFRS 15.BC46E.

significant facts and circumstances change (see Question 3-5 for further discussion). We discuss each of the italicised concepts below:

Probable – For purposes of this analysis, the meaning of the term 'probable' is consistent with the existing definition in IFRS, i.e., "more likely than not".[64] If it is not probable that the entity will collect amounts to which it is entitled, the model in IFRS 15 is not applied to the contract until the concerns about collectability have been resolved. However, other requirements in IFRS 15 apply to such arrangements (see section 3.5 for further discussion).

Consideration to which it will be entitled in exchange for the goods or services that will be transferred to a customer – The amount of consideration that is assessed for collectability is the amount to which the entity will be entitled. That is, the amount of consideration assessed for collectability is often the transaction price, but it may be a lesser amount in certain circumstances, as discussed further below.

It is important to note that the transaction price might be less than the stated contract price for the goods or services in the contract. Entities need to determine the transaction price in Step 3 of the model (as discussed in section 5) before assessing the collectability of that amount. The contract price and transaction price most often will differ because of variable consideration (e.g., rebates, discounts, explicit or implicit price concessions) that reduces the amount of consideration stated in the contract. For example, the transaction price for the items expected to be transferred may be less than the stated contract price for those items if an entity concludes that it has offered, or is willing to accept, a price concession on products sold to a customer. See section 5.2.1.A for further discussion on price concessions.

An entity deducts from the contract price any variable consideration that would reduce the amount of consideration to which it expects to be entitled (e.g., an estimated price concession) at contract inception in order to derive the transaction price for those items. The collectability assessment is then performed on the determined transaction price.

IFRS 15.9(e) specifies that an entity should assess the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer (rather than the total amount promised for all goods or services in the contract). In the Basis for Conclusions, the Board noted that, if the customer were to fail to perform as promised and the entity were able to stop transferring additional goods or services to the customer in response, the entity would not consider the likelihood of payment for those goods or services that would not be transferred in its assessment of collectability.[65]

In the Basis for Conclusions, the Board also noted that the assessment of collectability criteria requires an entity to consider how the entity's contractual rights to the consideration relate to its performance obligations. That assessment considers the business practices available to the entity to manage its exposure to credit risk throughout the contract (e.g., through advance payments or the right to stop transferring additional goods or services).[66]

In addition to the IFRS 15 collectability assessment, an entity has to assess any contract assets or trade receivables arising from an IFRS 15 contract under the expected credit loss model in IFRS 9 (see section 10.1).

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[64] IFRS 5 Appendix A.
[65] IFRS 15.BC46.
[66] IFRS 15.BC46C.

Variable consideration versus credit risk

In the Basis for Conclusions on IFRS 15, the IASB acknowledged that in some cases, it may be difficult to determine whether the entity has implicitly offered a price concession (i.e., variable consideration) or whether the entity has chosen to accept the risk of default by the customer of the contractually agreed-upon consideration (i.e., impairment losses under IFRS 9).[67] The Board did not develop detailed guidance for distinguishing between price concessions (recognised as variable consideration through revenue) and an expected credit loss to be accounted for as an impairment loss under IFRS 9 (i.e., outside revenue). Therefore, an entity needs to consider all relevant facts and circumstances when analysing situations in which, at contract inception, it is willing to accept a lower price than the amount stated in the contract. In section 5.2.1.A, we discuss certain factors that may suggest the entity has implicitly offered a price concession to the customer.

After the entity has determined the amount to assess for collectability under IFRS 15.9(e), it also has to apply the requirements in IFRS 9 to account for any expected credit losses for the receivable (or contract asset) that is recorded (i.e., after consideration of any variable consideration, such as an implicit price concession). Also, it should present any resulting impairment loss as an expense under IFRS 9 (i.e., not as a reduction of the transaction price).

Examples 2 (included in section 5.2.1.A), 3 and 23 (included in section 5.2.3) from the standard illustrate situations where the transaction price that is evaluated for collectability is not the amount stated in the contract. In contrast, the TRG discussed an example (included in Question 3-4 below) in which an entity, at contract inception, believes it is probable that its customers will pay amounts owed and the transaction price (i.e., revenue recorded) equals the contract price, even though, on a portfolio basis, 2% is not expected to be collected.

[67] IFRS 15.BC194.

Example of assessment of the collectability criterion

The standard provides the following example of how an entity would assess the collectability criterion:

Extract from IFRS 15

Example 1 — Collectability of the consideration (IFRS 15.IE3-IE6)

An entity, a real estate developer, enters into a contract with a customer for the sale of a building for CU1 million. The customer intends to open a restaurant in the building. The building is located in an area where new restaurants face high levels of competition and the customer has little experience in the restaurant industry.

The customer pays a non-refundable deposit of CU50,000 at inception of the contract and enters into a long-term financing agreement with the entity for the remaining 95 per cent of the promised consideration. The financing arrangement is provided on a non-recourse basis, which means that if the customer defaults, the entity can repossess the building, but cannot seek further compensation from the customer, even if the collateral does not cover the full value of the amount owed. The entity's cost of the building is CU600,000. The customer obtains control of the building at contract inception.

In assessing whether the contract meets the criteria in paragraph 9 of IFRS 15, the entity concludes that the criterion in paragraph 9(e) of IFRS 15 is not met because it is not probable that the entity will collect the consideration to which it is entitled in exchange for the transfer of the building. In reaching this conclusion, the entity observes that the customer's ability and intention to pay may be in doubt because of the following factors:

(a) the customer intends to repay the loan (which has a significant balance) primarily from income derived from its restaurant business (which is a business facing significant risks because of high competition in the industry and the customer's limited experience);

(b) the customer lacks other income or assets that could be used to repay the loan; and

(c) the customer's liability under the loan is limited because the loan is non-recourse.

Because the criteria in paragraph 9 of IFRS 15 are not met, the entity applies paragraphs 15-16 of IFRS 15 to determine the accounting for the non-refundable deposit of CU50,000. The entity observes that none of the events described in paragraph 15 have occurred—that is, the entity has not received substantially all of the consideration and it has not terminated the contract.

Extract from IFRS 15 (cont'd)

Consequently, in accordance with paragraph 16, the entity accounts for the non-refundable CU50,000 payment as a deposit liability. The entity continues to account for the initial deposit, as well as any future payments of principal and interest, as a deposit liability, until such time that the entity concludes that the criteria in paragraph 9 are met (ie the entity is able to conclude that it is probable that the entity will collect the consideration) or one of the events in paragraph 15 has occurred. The entity continues to assess the contract in accordance with paragraph 14 to determine whether the criteria in paragraph 9 are subsequently met or whether the events in paragraph 15 of IFRS 15 have occurred.

How we see it

At contract inception, significant judgement is required to determine when an expected partial payment indicates that: (1) there is an implied price concession in the contract that affects the determination of the transaction price and the amount assessed for collectability under IFRS 15; (2) there is an expected credit loss (accounted for as an impairment loss under IFRS 9); or (3) the arrangement lacks sufficient substance to be considered a contract under the standard. See section 5.2.1.A for further discussion on implicit price concessions.

FASB differences

ASC 606 also uses the term 'probable' for the collectability assessment. However, 'probable' under US GAAP is a higher threshold than under IFRS.[68]

The FASB's standard includes additional guidance to clarify the intention of the collectability assessment. However, the IASB stated in the Basis for Conclusions on IFRS 15 that it does not expect differences in outcomes under IFRS and US GAAP in relation to the evaluation of the collectability criterion.[69]

[68] For US GAAP, the term 'probable' is defined in the master glossary of the US Accounting Standards Codificiation as "the future event or events are likely to occur".

[69] IFRS 15.BC46E.

Frequently asked questions

Question 3-4: How would an entity assess collectability for a portfolio of contracts? [TRG meeting 26 January 2015 — Agenda paper no. 13]

TRG members generally agreed that if an entity has determined it is probable that a customer will pay amounts owed under a contract, but the entity has historical experience that it will not collect consideration from some of the customers within a portfolio of contracts (see section 3.3.1), it would be appropriate for the entity to record revenue for the contract in full and separately evaluate the corresponding contract asset or receivable for impairment. That is, the entity would not conclude the arrangement contains an implicit price concession and would not reduce revenue for the uncollectable amounts. See section 5.2.1.A for a discussion of evaluating whether an entity has offered an implicit price concession.

Consider the following example included in the TRG agenda paper:

Example of assessing collectability for a portfolio of contracts

An entity has a large volume of similar customer contracts for which it invoices its customers in arrears, on a monthly basis. Before accepting a customer, the entity performs procedures designed to determine if it is probable that the customer will pay the amounts owed. It does not accept customers if it is not probable that the customer will pay the amounts owed. Because these procedures are only designed to determine whether collection is probable (and, thus, not a certainty), the entity anticipates that it will have some customers that will not pay all of the amounts owed. While the entity collects the entire amount due from the vast majority of its customers, on average, the entity's historical evidence (which is representative of its expectations for the future) indicates that the entity will only collect 98% of the amounts invoiced. In this case, the entity would recognise revenue for the full amount due. That is, when the entity satisfies the performance obligations in the contracts, it would recognise revenue of 100% of the amount due and a corresponding receivable for the same amount representing its unconditional right to the full consideration. It would then recognise an impairment loss in accordance with IFRS 9 for 2% of the amount due (i.e., the amount the entity does not expect to collect).

In this example, the entity concludes that collectability is probable for each customer based on procedures it performed prior to accepting each customer and on its historical experience with this customer class, while also accepting that there is some credit risk inherent with this customer class. Furthermore, the entity concludes that any amounts not collected do not represent implied price concessions. Instead, they are due to credit risk that is present in a limited number of customer contracts.

Some TRG members cautioned that the analysis to determine whether to recognise an impairment loss for a contract in the same period in which revenue is recognised (instead of reducing revenue for an anticipated price concession) will require judgement.

Frequently asked questions (cont'd)

Question 3-5: When would an entity reassess collectability? [TRG meeting 26 January 2015 — Agenda paper no. 13]

As discussed in section 3.1, IFRS 15.13 requires an entity to reassess whether it is probable that it will collect the consideration to which it will be entitled when significant facts and circumstances change. Example 4 in IFRS 15 illustrates a situation in which a customer's financial condition declines and its current access to credit and available cash on hand is limited. In this case, the entity does not reassess the collectability criterion. However, in a subsequent year, the customer's financial condition further declines after losing access to credit and its major customers. Example 4 in IFRS 15 illustrates that this subsequent change in the customer's financial condition is so significant that a reassessment of the criteria for identifying a contract is required, resulting in the collectability criterion not being met.[70] As noted in the TRG agenda paper, this example illustrates that it was not the Board's intent to require an entity to reassess collectability when changes occur that are relatively minor in nature (i.e., those that do not call into question the validity of the contract). TRG members generally agreed that entities need to exercise judgement to determine whether changes in the facts and circumstances are significant enough to indicate that a contract no longer exists under the standard.[71]

Example 4 in the standard also notes that the entity accounts for any impairment of the existing receivable in accordance with IFRS 9.[72]

3.2 Contract enforceability and termination clauses (updated October 2020)

An entity has to determine the duration of the contract (i.e., the stated contractual term or a shorter period) before applying certain aspects of the revenue model (e.g., identifying performance obligations, determining the transaction price). The contract duration under IFRS 15 is the period in which parties to the contract have present enforceable rights and obligations. An entity cannot assume that there are present enforceable rights and obligations for the entire term stated in the contract and it is likely that an entity will have to consider enforceable rights and obligations in individual contracts, as described in the standard:

Extract from IFRS 15

11. Some contracts with customers may have no fixed duration and can be terminated or modified by either party at any time. Other contracts may automatically renew on a periodic basis that is specified in the contract. An entity shall apply this Standard to the duration of the contract (ie the contractual period) in which the parties to the contract have present enforceable rights and obligations.

The period in which enforceable rights and obligations exist may be affected by termination provisions in the contract. Significant judgement is required to determine the effect of termination provisions on the contract duration. Entities need to review the overall contractual arrangements, including any master service arrangements, wind-down provisions and business practices to identify

[70] IFRS 15.IE14-IE17.
[71] TRG Agenda paper no. 25, *January 2015* Meeting – Summary of Issues Discussed and Next Steps, dated 30 March 2015.
[72] IFRS 15.IE17.

terms or conditions that might affect the enforceable rights and obligations in their contracts.

Under the standard, this determination is critical because the contract duration to which the standard is applied may affect the number of performance obligations identified and the determination of the transaction price. It may also affect the amounts disclosed in some of the required disclosures. See Question 3-6 below for further discussion on how termination provisions may affect the contract duration.

If each party has the unilateral right to terminate a 'wholly unperformed' contract (as defined in IFRS 15.12) without compensating the counterparty, IFRS 15 states that, for purposes of the standard, a contract does not exist and its accounting and disclosure requirements would not apply. This is because the contracts would not affect an entity's financial position or performance until either party performs. Any arrangement in which the entity has not provided any of the contracted goods or services and has not received or is not entitled to receive any of the contracted consideration is considered to be a 'wholly unperformed' contract.

The requirements for 'wholly unperformed' contracts do not apply if the parties to the contract have to compensate the other party if they exercise their right to terminate the contract and that termination payment is considered substantive.

How we see it

Under IFRS 15, entities are required to account for contracts with longer stated terms as month-to-month (or possibly a shorter duration) contracts if the parties can terminate the contract without penalty.

Entities need to consider all facts and circumstances to determine the contract duration. For example, entities may need to use significant judgement to determine whether a termination payment is substantive and the effect of a termination provision on contract duration.

Frequently asked questions

Question 3-6: How do termination clauses and termination payments affect the duration of a contract (i.e., the contractual period)? [TRG meeting 31 October 2014 – Agenda paper no. 10]

Entities need to carefully evaluate termination clauses and any related termination payments to determine how they affect contract duration (i.e., the period in which there are enforceable rights and obligations).

TRG members generally agreed that enforceable rights and obligations exist throughout the term in which each party has the unilateral enforceable right to terminate the contract by compensating the other party. For example, if a contract includes a substantive termination payment, the duration of the contract would equal the period through which a termination penalty would be due. This could be the stated contractual term or a shorter duration if the termination penalty does not extend to the end of the contract. However, TRG members observed that the determination of whether a termination penalty is substantive, and what constitutes enforceable rights and obligations under a contract, requires judgement and consideration of the facts and circumstances. The TRG agenda paper also noted that, if an entity concludes that the duration of the contract is less than the stated term because of a termination clause, any termination penalty needs to be included in the transaction price. If the termination penalty is variable, the requirements for variable consideration, including the constraint (see section 5.2.3), apply.

Frequently asked questions (cont'd)

TRG members also agreed that if a contract with a stated contractual term can be terminated by either party at any time for no consideration, the contract duration ends when control of the goods or services that have already been provided transfers to the customer (e.g., a month-to-month service contract), regardless of the contract's stated contractual term. In this case, entities also need to consider whether a contract includes a notification or cancellation period (e.g., the contract can be terminated with 90 days' notice) that would cause the contract duration to extend beyond the date when control of the goods or services that have already been provided were transferred to the customer. If such a period exists, the contract duration would be shorter than the stated contractual term, but would extend beyond the date when control of the goods or services that have already been provided were transferred to the customer. Consider the following examples that illustrate how termination provisions affect the duration of a contract:

Illustration 3-2 — Determining the duration of the contract

Entity A enters into a four-year service contract with a customer. The customer is required to pay a non-refundable annual fee of CU100,000, which is the stand-alone selling price for each year of service.

To determine the duration of the contract in each of the scenarios below, the entity considers these facts and whether the contract provides cancellation rights and termination penalties.

Scenario A: Assume no cancellation rights are provided to either party. In this case, the enforceable rights and obligations exist for the entire stated contractual term and the contract duration is four years.

Scenario B: Assume the contract provides the customer with a right to cancel the contract at the end of each year without cause, but with a termination penalty. The penalty decreases annually throughout the contract term at the end of each year. The following illustrates the payments under the contract:

	Year 1	Year 2	Year 3	Year 4
Annual fee (CU)	100,000	100,000	100,000	100,000
Termination penalty (CU)	225,000	150,000	75,000	-

If Entity A determines that the penalty is substantive in each period, enforceable rights and obligations exist for the stated contractual term of four years.

Scenario C: Assume the contract provides the customer with a right to cancel at the end of each year, with no termination penalty.

In this case, Entity A determines that the contract duration is one year, with options to renew for each of the following three years because the customer can choose whether to receive the service during those years. That is, Entity A determines that enforceable rights and obligations do not exist throughout the entire stated contractual term because there is no substantive termination penalty. The options to renew are not material rights because they are offered at the stand-alone selling price of CU100,000.

Frequently asked questions (cont'd)

Illustration 3-3 — Duration of a contract without a termination penalty

Entity A enters into a three-year contract with a customer to provide maintenance services. Entity A begins providing the services immediately. Consideration is payable in equal monthly instalments and each party has the unilateral right to terminate the contract without compensating the other party if it provides 30 days' notice.

While the stated contractual term is three years, Entity A's rights and obligations are enforceable only for 30 days. Therefore, under IFRS 15, the contract is accounted for as a one-month contract with a renewal option for additional months of maintenance services. This is because the customer or Entity A could cancel the agreement with 30 days' notice without paying a substantive termination payment.

Entity A also needs to evaluate the accounting for the renewal option(s) to determine whether it is a material right (see section 4.6).

Question 3-7: How should an entity evaluate the contract term when only the customer has the right to cancel the contract without cause and how do termination penalties affect this analysis? [TRG meeting 9 November 2015 – Agenda paper no. 48]

Enforceable rights and obligations exist throughout the term in which each party has the unilateral enforceable right to terminate the contract by compensating the other party. Members of the TRG did not view a customer-only right to terminate sufficient to warrant a different conclusion than one in which both parties have the right to terminate, as discussed in Question 3-8.

TRG members generally agreed that a substantive termination penalty payable by a customer to the entity is evidence of enforceable rights and obligations of both parties throughout the period covered by the termination penalty. For example, consider a four-year service contract in which the customer has the right to cancel without cause at the end of each year, but for which the customer would incur a termination penalty that decreases each year and is determined to be substantive. TRG members generally agreed that the arrangement would be treated as a four-year contract. Refer to Illustration 3-2, Scenario B in Question 3-6.

TRG members also discussed situations in which a contractual penalty would result in including optional goods or services in the accounting for the original contract (see Question 4-18 in section 4.6).

Frequently asked questions (cont'd)

TRG members observed that the determination of whether a termination penalty is substantive, and what constitutes enforceable rights and obligations under a contract, requires judgement and consideration of the facts and circumstances. In addition, it is possible that payments that effectively act as a termination penalty and create or negate enforceable rights and obligations may not be labelled as such in a contract. The TRG agenda paper included an illustration in which an entity sells equipment and consumables. The equipment is sold at a discount, but the customer is required to repay some or all of the discount if it does not purchase a minimum number of consumables. The TRG paper concludes that the penalty (i.e., forfeiting the upfront discount) is substantive and is evidence of enforceable rights and obligations up to the minimum quantity. This example is discussed further in Question 4-18 of section 4.6.

If enforceable rights and obligations do not exist throughout the entire term stated in the contract, TRG members generally agreed that customer cancellation rights would be treated as customer options. Examples include when there are no (or non-substantive) contractual penalties that compensate the entity upon cancellation and when the customer has the unilateral right to terminate the contract for reasons other than cause or contingent events outside the customer's control. In the Basis for Conclusions, the Board noted that a cancellation option or termination right can be similar to a renewal option.[73] An entity would need to determine whether a cancellation option indicates that the customer has a material right that would need to be accounted for as a performance obligation (e.g., there is a discount for goods or services provided during the cancellable period that provides the customer with a material right) (see section 4.6 for further discussion on customer options and the determination of whether an option represents a material right).

Question 3-8: If an entity has a past practice of not enforcing termination payments, does this affect the duration of the contract (i.e., the contractual period)? [TRG meeting 31 October 2014 – Agenda paper no. 10]

The TRG agenda paper noted that the evaluation of the termination payment in determining the duration of a contract depends on whether the law (which may vary by jurisdiction) considers past practice as limiting the parties' enforceable rights and obligations. An entity's past practice of allowing customers to terminate the contract early without enforcing collection of the termination payment only affects the contract duration in cases in which the parties' legally enforceable rights and obligations are limited because of the lack of enforcement by the entity. If that past practice does not change the parties' legally enforceable rights and obligations, the contract duration equals the period throughout which a substantive termination penalty would be due (which could be the stated contractual term or a shorter duration if the termination penalty did not extend to the end of the contract).

[73] IFRS 15.BC391.

Frequently asked questions (cont'd)

Question 3-9: How would an entity account for a partial termination of a contract (e.g., a change in the contract term from three years to two years prior to the beginning of year two)?

We believe an entity should account for the partial termination of a contract as a contract modification (see section 3.4) because it results in a change in the scope of the contract. IFRS 15 states that "a contract modification exists when the parties to a contract approve a modification that either creates new or changes existing enforceable rights and obligations of the parties to the contract".[74] A partial termination of a contract results in a change to the enforceable rights and obligations in the existing contract (also see Question 3-20 in section 3.4.2 regarding contract modifications that decrease the scope of a contract). This conclusion is consistent with the TRG agenda paper no. 48, which states, "a substantive termination penalty is evidence of enforceable rights and obligations throughout the contract term. The termination penalty is ignored until the contract is terminated at which point it is accounted for as a modification".[75]

Consider the following example:

Illustration 3-4 — Partial termination of a contract

An entity enters into a contract with a customer to provide monthly maintenance services for three years at a fixed price of CU500 per month (i.e., total consideration of CU18,000). The contract includes a termination clause that allows the customer to cancel the third year of the contract by paying a termination penalty of CU1,000 (which is considered substantive for the purpose of this example). The penalty would effectively result in an adjusted price per month for two years of CU542 (i.e., total consideration of CU13,000). At the end of the first year, the customer decides to cancel the third year of the contract and pays the CU1,000 termination penalty specified in the contract.

In this example, the modification is not accounted for as a separate contract because it does not result in the addition of distinct goods or services (see section 3.4.2). Since the remaining services are distinct, the entity applies the requirements in IFRS 15.21(a) and accounts for the modification prospectively. The remaining consideration of CU7,000 (CU6,000 per year under the original contract for the second year, plus the CU1,000 payment upon modification) is recognised over the remaining revised contract period of one year. That is, the entity recognises the CU1,000 termination penalty over the remaining performance period.

Question 3-10: How is consideration that was received from a customer, but not yet recognised as revenue, accounted for when the contract is cancelled?

When a contract is cancelled (by either the customer or the entity) it is a contract modification that reduces the scope of the contract. As discussed in Questions 3-9 and 3-20, such a modification would not be accounted for as a separate contract because it does not result in the addition of distinct goods or services. Rather, the accounting will depend on whether there are

[74] IFRS 15.18.

[75] TRG Agenda paper no. 48, *Customer options for additional goods and services,* dated 9 November 2015, paragraph 47a.

Frequently asked questions (cont'd)

any remaining goods and services to be provided after the cancellation and, if so, whether they are distinct from the goods and services already provided.

If there are no remaining goods and services to be provided after the cancellation, the accounting depends on whether the consideration is refundable or non-refundable. To determine whether consideration is refundable or non-refundable, entities may need to consider termination penalties, legal requirements for refund, customary business practices of providing refunds or statements made to customers that create a constructive or legal obligation to provide a refund.

If the consideration received from the customer is refundable and there are no remaining goods and services to be provided after the cancellation, the entity has a refund liability. This might require the entity to reclassify any existing contract liability to refund liability. In some cases, the entity might ask the customer to waive their right to a refund of the consideration in exchange for vouchers, for example, and/or discounts on future goods or services. The accounting for such offers (including the accounting for the liability) depends on the specific facts and circumstances and may require judgement.

If the consideration received from the customer is non-refundable and there are no remaining goods and services to be provided after the cancellation, we believe that the entity can recognise revenue for the consideration received when the contract is cancelled, and the related contract liability would also be derecognised. This accounting treatment is similar to the application guidance for breakage (e.g., for gift cards, see section 7.9) and the recognition of revenue for arrangements that fail the IFRS 15 contract criteria in accordance with IFRS 15.15 (see section 3.5). In both of those situations, IFRS 15 provides guidance that permits an entity to derecognise a liability and recognise revenue, provided the relevant criteria are met, when: the entity expects the customer will not exercise its contractual rights (for breakage);[76] or the contract is effectively completed or cancelled (for contracts that do not meet the contract criteria in IFRS 15.9).[77]

In some cases, an entity may be entitled to termination fees in the event of cancellation. The accounting for termination fees is discussed in Question 3-9.

Question 3-11: How does an entity account for services provided during a period after contract expiration in which enforceable rights and obligations do not exist until the contract is renewed?

If an entity continues to provide services to a customer during a period when a contract does not exist because a previous contract has expired and the contract has not yet been renewed, we believe that the entity would need to recognise revenue for providing those services on a cumulative catch-up basis at the time the contract is renewed (i.e., when enforceable rights and obligations exist between the entity and its customer).

[76] IFRS 15.B46
[77] IFRS 15.15, BC48

Frequently asked questions (cont'd)

As discussed in section 3, determining whether an enforceable contract exists under the model may require judgement and an evaluation of the relevant legal framework.

This approach to record revenue on a cumulative catch-up basis reflects the performance obligations that are partially satisfied at the time enforceable rights and obligations exist and is consistent with the overall principle of the standard that requires revenue to be recognised when (or as) an entity transfers control of goods or services to a customer under an enforceable contract. This conclusion is also consistent with the discussion in Question 7-18 on the accounting for goods or services provided to a customer before the contract establishment date.

Consider the following example:

Illustration 3-5 — Services provided during a period after contract expiration

Entity A enters into a non-cancellable one-year contract with a customer on 1 January 20X1 to provide web-hosting services that are transferred to the customer over time. The total consideration of CU1,200 is payable upfront and is non-refundable. After the expiration of the contract, at its discretion, Entity A continues to provide web-hosting services to the customer for a limited time to allow the customer to contemplate renewing the contract. If the customer renews the contract, the pricing would include the web-hosting services provided during the period between the original contract expiration and the contract renewal.

The customer agrees to renew the contract on 1 February 20X2. Entity A agrees to provide web-hosting services from 1 January 20X2 to 31 December 20X2 for total consideration of CU1,200, which is payable on the renewal date. Entity A determines that enforceable rights and obligations exist on 1 February 20X2 and recognises revenue on a cumulative catch-up basis to reflect the entity's transfer of control of the web-hosting services for one month (i.e., January 20X2). Accordingly, Entity A recognises CU100 on 1 February 20X2 for the web-hosting services provided to the customer before the renewal date. The remaining consideration of CU1,100 is recognised from 1 February 20X2 to 31 December 20X2 as the entity performs.

An entity might receive consideration from the customer for the goods or services transferred before the existence of an enforceable contract. If so, the entity would need to follow the requirements in IFRS 15.14-16 (discussed in section 3.5). This requires that when an arrangement does not meet the criteria to be a contract under the standard, an entity would recognise the non-refundable consideration received as revenue only if one of the two events has occurred (e.g., the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable).

3.3 Combining contracts (updated October 2018)

In most cases, entities apply the model to individual contracts with a customer. However, the standard requires entities to combine contracts entered into at, or near, the same time with the same customer (or related parties of the customer as defined in IAS 24 *Related Party Disclosures*) if they meet one or more of the criteria below:[78]

- The contracts are negotiated together with a single commercial objective
- The consideration to be paid for one contract is dependent on the price or performance of another contract
- The goods or services promised in the contracts are a single performance obligation (see section 4)

In the Basis for Conclusions, the Board explained that it included the requirements on combining contracts in the standard because, in some cases, the amount and timing of revenue may differ depending on whether an entity accounts for contracts as a single contract or separately.[79]

Entities need to apply judgement to determine whether contracts are entered into at or near the same time because the standard does not provide a bright line for making this assessment. In the Basis for Conclusions, the Board noted that the longer the period between entering into different contracts, the more likely it is that the economic circumstances affecting the negotiations of those contracts will have changed.[80]

Negotiating multiple contracts at the same time is not sufficient evidence to demonstrate that the contracts represent a single arrangement for accounting purposes. In the Basis for Conclusions, the Board noted that there are pricing interdependencies between two or more contracts when either of the first two criteria (i.e., the contracts are negotiated with a single commercial objective or the price in one contract depends on the price or performance of the other contract) are met, so the amount of consideration allocated to the performance obligations in each contract may not faithfully depict the value of the goods or services transferred to the customer if those contracts were not combined.

The Board also explained that it decided to include the third criterion (i.e., the goods or services in the contracts are a single performance obligation) to avoid any structuring opportunities that would effectively allow entities to bypass the requirements for identifying performance obligations.[81] That is, an entity cannot avoid determining whether multiple promises made to a customer at, or near, the same time need to be bundled into one or more performance obligations in accordance with Step 2 of the model (see section 4) solely by including the promises in separate contracts.

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[78] IFRS 15.BC74
[79] IFRS 15.BC71.
[80] IFRS 15.BC75.
[81] IFRS 15.BC73.

3.3.1 Portfolio approach practical expedient

Under the standard, the five-step model is applied to individual contracts with customers, unless the contract combination requirements discussed in section 3.3 are met. However, the IASB recognised that there may be situations in which it may be more practical for an entity to group contracts for revenue recognition purposes, rather than attempt to account for each contract separately. Specifically, the standard includes the following practical expedient:

Extract from IFRS 15

4. This Standard specifies the accounting for an individual contract with a customer. However, as a practical expedient, an entity may apply this Standard to a portfolio of contracts (or *performance obligations*) with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this Standard to the portfolio would not differ materially from applying this Standard to the individual contracts (or performance obligations) within that portfolio. When accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.

In order to use the portfolio approach, an entity must reasonably expect that the accounting result will not be materially different from the result of applying the standard to the individual contracts. However, in the Basis for Conclusions, the Board noted that it does not intend for an entity to quantitatively evaluate every possible outcome when concluding that the portfolio approach is not materially different. Instead, they indicated that an entity should be able to take a reasonable approach to determine portfolios that are representative of its types of customers and that an entity should use judgement in selecting the size and composition of those portfolios.[82]

How we see it

Application of the portfolio approach will likely vary based on the facts and circumstances of each entity. An entity may choose to apply the portfolio approach to only certain aspects of the model (e.g., determining the transaction price in Step 3).

Frequently asked questions

Question 3-12: How would an entity assess collectability for a portfolio of contracts? [TRG meeting 26 January 2015 – Agenda paper no. 13]

See response to Question 3-4 in section 3.1.5.

[82] IFRS 15.BC69.

3.4 Contract modifications (updated October 2020)

Parties to an arrangement frequently agree to modify the scope or price (or both) of their contract. If that happens, an entity must determine whether the modification is accounted for as a new contract or as part of the existing contract. Generally, it is clear when a contract modification has taken place, but in some circumstances, that determination is more difficult. To assist entities when making this determination, the standard states the following:

Extract from IFRS 15

18. A contract modification is a change in the scope or price (or both) of a contract that is approved by the parties to the contract. In some industries and jurisdictions, a contract modification may be described as a change order, a variation or an amendment. A contract modification exists when the parties to a contract approve a modification that either creates new or changes existing enforceable rights and obligations of the parties to the contract. A contract modification could be approved in writing, by oral agreement or implied by customary business practices. If the parties to the contract have not approved a contract modification, an entity shall continue to apply this Standard to the existing contract until the contract modification is approved.

19. A contract modification may exist even though the parties to the contract have a dispute about the scope or price (or both) of the modification or the parties have approved a change in the scope of the contract but have not yet determined the corresponding change in price. In determining whether the rights and obligations that are created or changed by a modification are enforceable, an entity shall consider all relevant facts and circumstances including the terms of the contract and other evidence. If the parties to a contract have approved a change in the scope of the contract but have not yet determined the corresponding change in price, an entity shall estimate the change to the transaction price arising from the modification in accordance with paragraphs 50–54 on estimating variable consideration and paragraphs 56–58 on constraining estimates of variable consideration.

The extract above illustrates that the Board intended these requirements to apply more broadly than only to finalised modifications. That is, IFRS 15 indicates that an entity may have to account for a contract modification prior to the parties reaching final agreement on changes in scope or pricing (or both). Instead of focusing on the finalisation of a modification, IFRS 15 focuses on the enforceability of the changes to the rights and obligations in the contract. Once an entity determines the revised rights and obligations are enforceable, it accounts for the contract modification. Contract terminations (either partial or full) are also considered a form of contract modification under IFRS 15.

The standard provides the following example to illustrate the accounting for an unapproved modification:

Extract from IFRS 15

Example 9 — Unapproved change in scope and price (IFRS 15.IE42-IE43)

An entity enters into a contract with a customer to construct a building on customer-owned land. The contract states that the customer will provide the entity with access to the land within 30 days of contract inception. However, the entity was not provided access until 120 days after contract inception because of storm damage to the site that occurred after contract inception. The contract specifically identifies any delay (including *force majeure*) in the entity's access to customer-owned land as an event that entitles the entity to compensation that is equal to actual costs incurred as a direct result of the delay. The entity is able to demonstrate that the specific direct costs were incurred as a result of the delay in accordance with the terms of the contract and prepares a claim. The customer initially disagreed with the entity's claim.

The entity assesses the legal basis of the claim and determines, on the basis of the underlying contractual terms, that it has enforceable rights. Consequently, it accounts for the claim as a contract modification in accordance with paragraphs 18–21 of IFRS 15. The modification does not result in any additional goods and services being provided to the customer. In addition, all of the remaining goods and services after the modification are not distinct and form part of a single performance obligation. Consequently, the entity accounts for the modification in accordance with paragraph 21(b) of IFRS 15 by updating the transaction price and the measure of progress towards complete satisfaction of the performance obligation. The entity considers the constraint on estimates of variable consideration in paragraphs 56–58 of IFRS 15 when estimating the transaction price.

Once an entity has determined that a contract has been modified, the entity determines the appropriate accounting treatment for the modification. Certain modifications are treated as separate stand-alone contracts, while others are combined with the original contract and accounted for in that manner. In addition, an entity accounts for some modifications on a prospective basis and others on a cumulative catch-up basis. The Board developed different approaches to account for different types of modifications with an overall objective of faithfully depicting an entity's rights and obligations in each modified contract.[83]

[83] IFRS 15.BC76.

The standard includes the following requirements for determining the appropriate accounting treatment:

Extract from IFRS 15

20. An entity shall account for a contract modification as a separate contract if both of the following conditions are present:

(a) the scope of the contract increases because of the addition of promised goods or services that are distinct (in accordance with paragraphs 26–30); and

(b) the price of the contract increases by an amount of consideration that reflects the entity's stand-alone selling prices of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract. For example, an entity may adjust the stand-alone selling price of an additional good or service for a discount that the customer receives, because it is not necessary for the entity to incur the selling-related costs that it would incur when selling a similar good or service to a new customer.

21. If a contract modification is not accounted for as a separate contract in accordance with paragraph 20, an entity shall account for the promised goods or services not yet transferred at the date of the contract modification (ie the remaining promised goods or services) in whichever of the following ways is applicable:

(a) An entity shall account for the contract modification as if it were a termination of the existing contract and the creation of a new contract, if the remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification. The amount of consideration to be allocated to the remaining performance obligations (or to the remaining distinct goods or services in a single performance obligation identified in accordance with paragraph 22(b)) is the sum of:

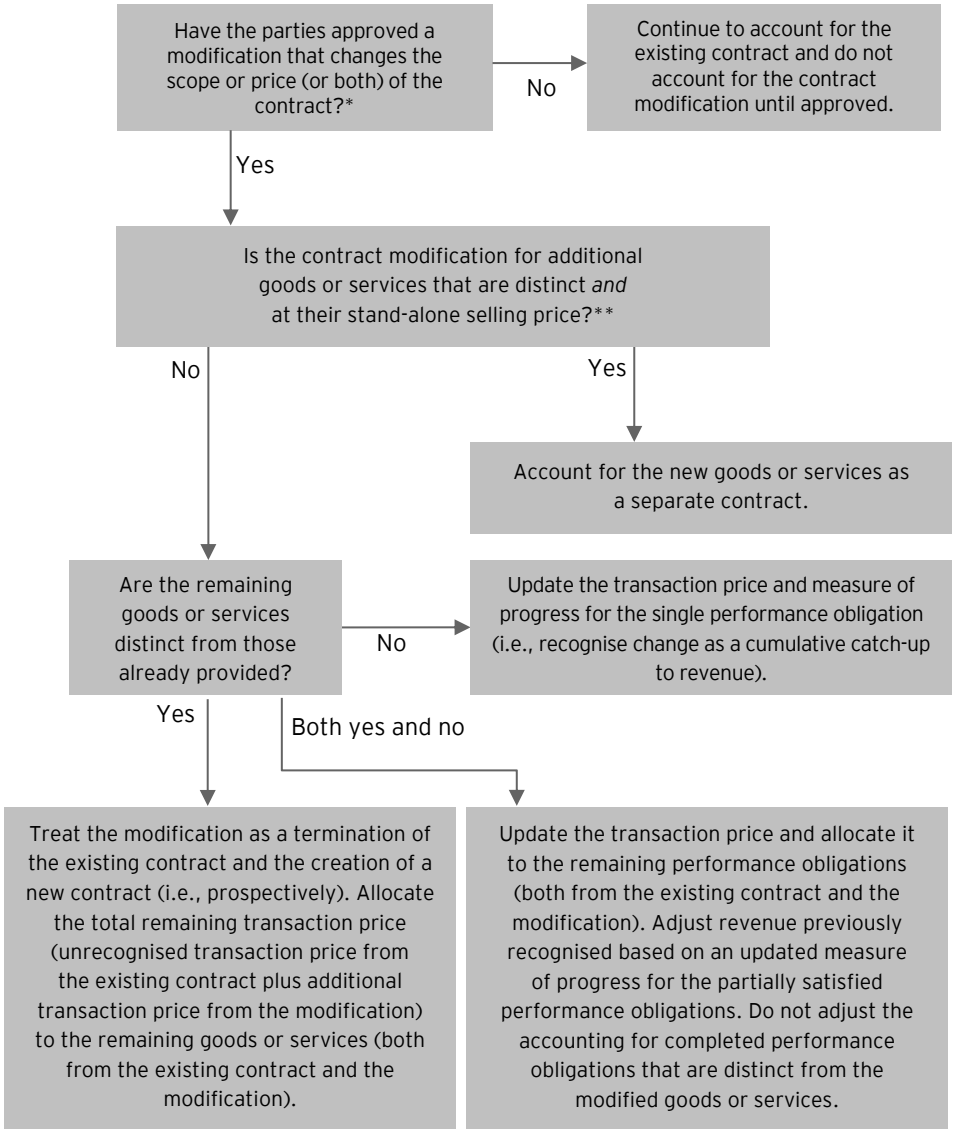
   (i) the consideration promised by the customer (including amounts already received from the customer) that was included in the estimate of the transaction price and that had not been recognised as revenue; and

   (ii) the consideration promised as part of the contract modification.

(b) An entity shall account for the contract modification as if it were a part of the existing contract if the remaining goods or services are not distinct and, therefore, form part of a single performance obligation that is partially satisfied at the date of the contract modification. The effect that the contract modification has on the transaction price, and on the entity's measure of progress towards complete satisfaction of the performance obligation, is recognised as an adjustment to revenue (either as an increase in or a reduction of revenue) at the date of the contract modification (ie the adjustment to revenue is made on a cumulative catch-up basis).

(c) If the remaining goods or services are a combination of items (a) and (b), then the entity shall account for the effects of the modification on the unsatisfied (including partially unsatisfied) performance obligations in the modified contract in a manner that is consistent with the objectives of this paragraph.

The following chart illustrates these requirements:



* Under IFRS 15, a contract modification can be approved in writing, by oral agreement or implied by customary business practices. IFRS 15.19 states that an entity may have to account for a contract modification prior to the parties reaching final agreement on changes in scope or pricing (or both), provided the rights and obligations that are created or changed by a modification are enforceable.

** In accordance with IFRS 15.20, an entity may make appropriate adjustments to the stand-alone selling price to reflect the circumstances of the contract and still meet the criteria to account for the modification as a separate contract.

When determining how to account for a contract modification, an entity must consider whether any additional goods or services are distinct, often giving careful consideration to whether those goods or services are distinct within the context of the modified contract (see sections 4.2.1 for further discussion on evaluating whether goods or services are distinct). That is, although a contract modification may add a new good or service that would be distinct in a stand-alone transaction, that new good or service may not be distinct when considered in the context of the contract, as modified. For example, in a building renovation project, a customer may request a contract modification to add a new room. The construction firm may commonly sell the construction of an added room on a stand-alone basis, which would indicate that the service is capable of being distinct. However, when that service is added to an existing contract and the entity has already determined that the entire project is a single performance obligation, the added goods or services would normally be combined with the existing bundle of goods or services.

In contrast to the construction example (for which the addition of otherwise distinct goods or services are combined with the existing single performance obligation and accounted for in that manner), a contract modification that adds distinct goods or services to a single performance obligation that comprise a series of distinct goods or services (see section 4.2.2) is accounted for either as a separate contract or as the termination of the old contract and the creation of a new contract (i.e., prospectively). In the Basis for Conclusions, the Board explained that it clarified the accounting for modifications that affect a single performance obligation that is made up of a series of distinct goods or services (e.g., repetitive service contracts) to address some stakeholders' concerns that an entity otherwise would have been required to account for these modifications on a cumulative catch-up basis.[84]

As illustrated in Example 5, Case B (see section 3.4.2), a contract modification may include compensation to a customer for performance issues (e.g., poor service by the entity, defects present in transferred goods). An entity may need to account for the compensation to the customer as a change in the transaction price (see section 6.5) separate from other modifications to the contract.

[84] IFRS 15.BC79.

Frequently asked questions

Question 3-13: When would an entity evaluate a contract under the contract modification requirements?

An entity typically enters into a separate contract with a customer to provide additional goods or services. Stakeholders had questioned whether a new contract with an existing customer needs to be evaluated under the contract modification requirements.

A new contract with an existing customer needs to be evaluated under the contract modification requirements if the new contract results in a change in the scope or price of the original contract. IFRS 15.18 states that "a contract modification exists when the parties to a contract approve a modification that either creates new or changes existing enforceable rights and obligations of the parties to the contract". Therefore, an entity needs to evaluate whether a new contract with an existing customer represents a legally enforceable change in scope or price to an existing contract. A legally enforceable change in scope or price to an existing contract could also be accomplished by terminating the existing contract and entering into a new contract with the same customer. In those situations, entities also need to consider the contract modification requirements in IFRS 15.

In some cases, the determination of whether a new contract with an existing customer creates new or changes existing enforceable rights and obligations is straightforward because the new contract does not contemplate goods or services in the existing contract, including the pricing of those goods or services. Purchases of additional goods or services under a separate contract that do not modify the scope or price of an existing contract do not need to be evaluated under the contract modification requirements. Rather, they are accounted for as new (separate) contract.

In other cases, the determination of whether a new contract is a modification of an existing contract requires judgement. In such circumstances, we believe an entity should consider the specific facts and circumstances surrounding the new contract in order to determine whether it represents a contract modification. This could include considering factors such as those included in the contract combination requirements (see section 3.3):

- Whether the contracts were negotiated as a package with a single commercial objective (this might be the case in situations where the existing contract contemplates future modifications).
- Whether the amount of consideration to be paid in one contract depends on the price or performance of the other contract.
- Whether the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation.

If the pricing in the new contract is dependent on the original contract, or if the terms of the new contract are in some other way negotiated based on the original contract, it is likely that the new contract needs to be evaluated under the contract modification requirements.

Frequently asked questions (cont'd)

Question 3-14: When an arrangement that has already been determined to meet the standard's contract criteria is modified, would an entity need to reassess whether that arrangement still meets the criteria to be considered a contract within the scope of the five-step model?

There is no specific requirement in the standard to reconsider whether a contract meets the definition of a contract when it is modified. However, if a contract is modified, we believe that may indicate that "a significant change in facts and circumstances" has occurred (see section 3.1) and that the entity should reassess the criteria in IFRS 15.9 for the modified contract. Any reassessment is prospective in nature and would not change the conclusions associated with goods or services already transferred. That is, an entity would not reverse any receivables, revenue or contract assets already recognised under the contract because of the reassessment of the contract criteria in IFRS 15.9. However, due to the contract modification accounting (see section 3.4.2), the entity may need to adjust contract assets or cumulative revenue recognised in the period of the contract modification.

Question 3-15: How would an entity distinguish between a contract modification and a change in the estimated transaction price due to variable consideration after contract inception?

An entity may need to apply judgement to determine whether a change in the transaction price is the result of a contract modification (due to a change in the parties' enforceable rights and obligations after contract inception) or the result of new information obtained about variable consideration that existed (and was estimated) at contract inception. While a contract modification may result in a change in the transaction price, not all changes in the transaction price are due to contract modifications.

When a contract with a customer includes variable consideration (see section 5.2), the entity is generally required to estimate, at contract inception and throughout the contract term, the amount of consideration to which it will be entitled in exchange for transferring promised goods or services. Changes to the transaction price that are related to a change in estimates of variable consideration (because they result in the resolution of variability that existed at contract inception), are allocated to the performance obligations in the contract on the same basis as at contract inception (see section 6.5).[85] In contrast, changes in the transaction price that are related to a contract modification are accounted for in accordance with the contract modification requirements (as described above in IFRS 15.18-21).

[85] IFRS 15.88-89.

Frequently asked questions (cont'd)

Question 3-16: How would an entity distinguish between a contract modification and a marketing offer when an enitity provides customer incentives?

An entity may provide incentives to customers to encourage demand. Customer incentives may include free goods or services, options for additional goods and services at a discount (e.g., additional loyalty points, prospective coupons or discounts) or cash payments to customers. The accounting for these incentives will depend on the facts and circumstances of the offer. An offer to a current customer that creates new enforceable rights and obligations or changes the enforceable rights and obligations of the parties to an existing contract is accounted for as a contract modification. In some cases, an offer may not result in a contract modification and would be accounted for as a marketing offer (i.e., expense).

An offer that is the result of negotiations with a specific customer or group of customers may indicate the addition of new enforceable rights and obligations to an existing contract or changes to existing ones. However, the following circumstances may indicate that the entity has made a marketing offer:

- The same offer is available to both existing customers and counterparties that do not meet the definition of a customer
- The offer is available to a broad group of (or all) current customers and is not the result of negotiations with individual customers
- The entity has the right to rescind the offer

Entities need to carefully consider the terms and conditions of any customer incentive to determine whether the offer needs to be accounted for as a contract modification or a marketing offer.

In addition, as discussed in Question 3-13, we believe that the accounting principles for determining when contracts have to be combined under IFRS 15.17 will be helpful when determining whether an offer of free goods or services to an existing customer is a contract modification.

For any payments to customers, entities will need to consider the requirements for consideration paid or payable to a customer (see section 5.7). Such payments would be accounted for as a reduction of the transaction price (and, therefore, revenue) unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity.

Question 3-17: How would an entity account for the exercise of a material right? That is, would an entity account for it as: a contract modification, a continuation of the existing contract or variable consideration? [TRG meeting 30 March 2015 – Agenda paper no. 32]

See response to Question 4-24 in section 4.6.

Question 3-18: How should entities account for modifications to licences of intellectual property?

See response to Question 8-1 in section 8.1.4.

3.4.1 Contract modification represents a separate contract (updated September 2019)

Certain contract modifications are treated as separate, new contracts.[86] For these modifications, the accounting for the original contract is not affected by the modification and the revenue recognised to date on the original contract is not adjusted. Furthermore, any performance obligations remaining under the original contract continue to be accounted for under the original contract. The accounting for this type of modification reflects the fact that there is no economic difference between a separate contract for additional goods or services and a modified contract for those same items, provided the two criteria required for this type of modification are met.

The first criterion that must be met for a modification to be treated as a separate contract is that the additional promised goods or services in the modification must be distinct from the promised goods or services in the original contract. This assessment is done in accordance with IFRS 15's general requirements for determining whether promised goods or services are distinct (see section 4.2.1). Only modifications that add distinct goods or services to the arrangement can be treated as separate contracts. Arrangements that reduce the amount of promised goods or services or change the scope of the original promised goods or services cannot, by their very nature, be considered separate contracts. Instead, they are modifications of the original contract (see section 3.4.2).[87]

The second criterion is that the amount of consideration expected for the added promised goods or services must reflect the stand-alone selling prices of those promised goods or services at the contract modification date. However, when determining the stand-alone selling price, entities have some flexibility to adjust the stand-alone selling price, depending on the facts and circumstances. For example, an entity may give an existing customer a discount on additional goods because the entity would not incur selling-related costs that it would typically incur for new customers. In this example, the entity may determine that the additional transaction consideration meets the criterion, even though the discounted price is less than the stand-alone selling price of that good or service for a new customer. In another example, an entity may conclude that, with the additional purchases, the customer qualifies for a volume-based discount (see Questions 4-20 and 4-21 in section 4.6 on volume discounts).[88]

[86] IFRS 15.20.
[87] IFRS 15.20(a).
[88] IFRS 15.20(b).

The following example illustrates considerations for determining whether the amount of consideration expected for the additional goods and services reflects the stand-alone selling price:

Illustration 3-6 — Determining whether the amount of consideration reflects the stand-alone selling price of additional goods or services

Entity E agrees to construct a manufacturing facility on a customer's land for CU10 million. During construction, the customer determines that a separate storage facility is needed at the location. The parties agree to modify the contract to include the construction of the storage facility, which is to be completed within three months of completing the manufacturing facility, for a total price of CU11 million (i.e., when the contract is modified, an additional CU1 million is added to the consideration Entity E will receive). Assume that Entity E determines that the construction of the separate storage facility is distinct (i.e., a performance obligation) and that it transfers control of each facility over time. Entity E must determine whether the CU1 million represents the stand-alone selling price of the separate storage facility.

Scenario A

Entity E determines that CU1.1 million is the stand-alone selling price at the contract modification date for the construction of a similar facility. However, much of the equipment and labour force necessary to complete construction of the storage facility is already onsite and available for use by Entity E. Thus, Entity E concludes that the additional CU1 million reflects the stand-alone selling price at contract modification, adjusted for the circumstances of the contract.

Scenario B

Entity E determines that CU1.5 million is the stand-alone selling price at the contract modification date for the construction of a similar facility. While Entity E can attribute some of the discount to its ability to use equipment and labour that are already onsite, the price reduction was primarily driven by other factors (e.g., a desire to maintain the customer relationship). Therefore, the additional CU1 million does not reflect the stand-alone selling price at contract modification.

In situations with highly variable pricing, determining whether the additional consideration in a modified contract reflects the stand-alone selling price for the additional goods or services may not be straightforward. Entities need to apply judgement when making this assessment. Evaluating whether the price in the modified contract is within a range of prices for which the goods or services are typically sold to similar customers may be an acceptable approach.

The following example illustrates a contract modification that represents a separate contract:

Extract from IFRS 15

Example 5 — Modification of a contract for goods (IFRS 15.IE19-IE21)

An entity promises to sell 120 products to a customer for CU12,000 (CU100 per product). The products are transferred to the customer over a six-month period. The entity transfers control of each product at a point in time. After the entity has transferred control of 60 products to the customer, the contract is modified to require the delivery of an additional 30 products (a total of 150 identical products) to the customer. The additional 30 products were not included in the initial contract.

Case A—Additional products for a price that reflects the stand-alone selling price

When the contract is modified, the price of the contract modification for the additional 30 products is an additional CU2,850 or CU95 per product. The pricing for the additional products reflects the stand-alone selling price of the products at the time of the contract modification and the additional products are distinct (in accordance with paragraph 27 of IFRS 15) from the original products.

In accordance with paragraph 20 of IFRS 15, the contract modification for the additional 30 products is, in effect, a new and separate contract for future products that does not affect the accounting for the existing contract. The entity recognises revenue of CU100 per product for the 120 products in the original contract and CU95 per product for the 30 products in the new contract.

3.4.2 Contract modification is not a separate contract (updated October 2020)

If the criteria discussed in section 3.4.1 are not met (i.e., distinct goods or services are not added or the distinct goods or services are not priced at their stand-alone selling price), the contract modifications are accounted for as changes to the original contract and not as separate contracts. This includes contract modifications that modify or remove previously agreed-upon goods or services or reduce the price of the contract. An entity accounts for the effects of these modifications differently, depending on which of the three scenarios described in IFRS 15.21 (see the extract in section 3.3) most closely aligns with the facts and circumstances of the modification.

Modification is a termination of the existing contract and the creation of a new contract

If the remaining goods or services after the contract modification are distinct from the goods or services transferred on, or before, the contract modification, the entity accounts for the modification as if it were a termination of the old contract and the creation of a new contract. For these modifications, the revenue recognised to date on the original contract (i.e., the amount associated with the completed performance obligations) is not adjusted. Instead, the remaining portion of the original contract and the modification are accounted for, together, on a prospective basis by allocating the remaining consideration (i.e., the unrecognised transaction price from the existing contract plus the additional transaction price from the modification) to the remaining performance obligations, including those added in the modification.

Example 7 in the standard illustrates the accounting for a contract modification of a services contract that is determined to be a series of distinct goods or services (see section 4.2.2) and meets the criteria in IFRS 15.21(a) to be accounted for as a termination of the existing contract and the creation of a new contract. As the performance obligation is a series, the services provided after the contract modification are distinct from those provided before the contract modification.[89]

The following example from the standard also illustrates a modification that is treated as a termination of an existing contract and the creation of a new contract:

Extract from IFRS 15

Example 5 — Modification of a contract for goods (IFRS 15.IE19, IE22-IE24)

An entity promises to sell 120 products to a customer for CU12,000 (CU100 per product). The products are transferred to the customer over a six-month period. The entity transfers control of each product at a point in time. After the entity has transferred control of 60 products to the customer, the contract is modified to require the delivery of an additional 30 products (a total of 150 identical products) to the customer. The additional 30 products were not included in the initial contract.

Case B—Additional products for a price that does not reflect the stand-alone selling price

During the process of negotiating the purchase of an additional 30 products, the parties initially agree on a price of CU80 per product. However, the customer discovers that the initial 60 products transferred to the customer contained minor defects that were unique to those delivered products. The entity promises a partial credit of CU15 per product to compensate the customer for the poor quality of those products. The entity and the customer agree to incorporate the credit of CU900 (CU15 credit × 60 products) into the price that the entity charges for the additional 30 products. Consequently, the contract modification specifies that the price of the additional 30 products is CU1,500 or CU50 per product. That price comprises the agreed-upon price for the additional 30 products of CU2,400, or CU80 per product, less the credit of CU900.

[89] IFRS 15.IE33-IE36.

Extract from IFRS 15 (cont'd)

At the time of modification, the entity recognises the CU900 as a reduction of the transaction price and, therefore, as a reduction of revenue for the initial 60 products transferred. In accounting for the sale of the additional 30 products, the entity determines that the negotiated price of CU80 per product does not reflect the stand-alone selling price of the additional products. Consequently, the contract modification does not meet the conditions in paragraph 20 of IFRS 15 to be accounted for as a separate contract. Because the remaining products to be delivered are distinct from those already transferred, the entity applies the requirements in paragraph 21(a) of IFRS 15 and accounts for the modification as a termination of the original contract and the creation of a new contract.

Consequently, the amount recognised as revenue for each of the remaining products is a blended price of CU93.33 {[(CU100 × 60 products not yet transferred under the original contract) + (CU80 × 30 products to be transferred under the contract modification)] ÷ 90 remaining products}.

In Example 5, Case B, in the extract above, the entity attributed a portion of the discount provided on the additional products to the previously delivered products because they contained defects. This is because the compensation provided to the customer for the previously delivered products is a discount on those products, which results in variable consideration (i.e., a price concession) for them. The new discount on the previously delivered products was recognised as a reduction of the transaction price (and, therefore, revenue) on the date of the modification. Changes in the transaction price after contract inception are accounted for in accordance with IFRS 15.88-90 (see section 6.5).

In similar situations, it may not be clear from the change in the contract terms whether an entity has offered a price concession on previously transferred goods or services to compensate the customer for performance issues related to those items (that would be accounted for as a reduction of the transaction price) or has offered a discount on future goods or services (that would be included in the accounting for the contract modification). An entity needs to apply judgement when performance issues exist for previously transferred goods or services to determine whether to account for any compensation to the customer as a change in the transaction price for those previously transferred goods or services.

Modification is part of the existing contract

The remaining goods or services to be provided after the contract modification may not be distinct from those goods or services already provided and, therefore, form part of a single performance obligation that is partially satisfied at the date of modification. If this is the case, the entity accounts for the contract modification as if it were part of the original contract. The entity adjusts revenue previously recognised (either up or down) to reflect the effect that the contract modification has on the transaction price and update the measure of progress (i.e., the revenue adjustment is made on a cumulative catch-up basis). This scenario is illustrated, as follows:

Extract from IFRS 15

Example 8 — Modification resulting in a cumulative catch-up adjustment to revenue (IFRS 15.IE37-IE41)

An entity, a construction company, enters into a contract to construct a commercial building for a customer on customer-owned land for promised consideration of CU1 million and a bonus of CU200,000 if the building is completed within 24 months. The entity accounts for the promised bundle of goods and services as a single performance obligation satisfied over time in accordance with paragraph 35(b) of IFRS 15 because the customer controls the building during construction.

At the inception of the contract, the entity expects the following:

	CU
Transaction price	1,000,000
Expected costs	700,000
Expected profit (30%)	300,000

At contract inception, the entity excludes the CU200,000 bonus from the transaction price because it cannot conclude that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. Completion of the building is highly susceptible to factors outside the entity's influence, including weather and regulatory approvals. In addition, the entity has limited experience with similar types of contracts.

The entity determines that the input measure, on the basis of costs incurred, provides an appropriate measure of progress towards complete satisfaction of the performance obligation. By the end of the first year, the entity has satisfied 60 per cent of its performance obligation on the basis of costs incurred to date (CU420,000) relative to total expected costs (CU700,000). The entity reassesses the variable consideration and concludes that the amount is still constrained in accordance with paragraphs 56–58 of IFRS 15. Consequently, the cumulative revenue and costs recognised for the first year are as follows:

	CU
Revenue	600,000
Costs	420,000
Gross profit	180,000

Extract from IFRS 15 (cont'd)

In the first quarter of the second year, the parties to the contract agree to modify the contract by changing the floor plan of the building. As a result, the fixed consideration and expected costs increase by CU150,000 and CU120,000, respectively. Total potential consideration after the modification is CU1,350,000 (CU1,150,000 fixed consideration + CU200,000 completion bonus). In addition, the allowable time for achieving the CU200,000 bonus is extended by 6 months to 30 months from the original contract inception date. At the date of the modification, on the basis of its experience and the remaining work to be performed, which is primarily inside the building and not subject to weather conditions, the entity concludes that it is highly probable that including the bonus in the transaction price will not result in a significant reversal in the amount of cumulative revenue recognised in accordance with paragraph 56 of IFRS 15 and includes the CU200,000 in the transaction price. In assessing the contract modification, the entity evaluates paragraph 27(b) of IFRS 15 and concludes (on the basis of the factors in paragraph 29 of IFRS 15) that the remaining goods and services to be provided using the modified contract are not distinct from the goods and services transferred on or before the date of contract modification; that is, the contract remains a single performance obligation.

Consequently, the entity accounts for the contract modification as if it were part of the original contract (in accordance with paragraph 21(b) of IFRS 15). The entity updates its measure of progress and estimates that it has satisfied 51.2 per cent of its performance obligation (CU420,000 actual costs incurred ÷ CU820,000 total expected costs). The entity recognises additional revenue of CU91,200 [(51.2 per cent complete × CU1,350,000 modified transaction price) – CU600,000 revenue recognised to date] at the date of the modification as a cumulative catch-up adjustment.

Modification is part of the existing contract and the creation of a new contract

Finally, a change in a contract may also be treated as a combination of the two: a modification of the existing contract and the creation of a new contract. In this case, an entity would not adjust the accounting treatment for completed performance obligations that are distinct from the modified goods or services. However, the entity would adjust revenue previously recognised (either up or down) to reflect the effect of the contract modification on the estimated transaction price allocated to performance obligations that are not distinct from the modified portion of the contract and would update the measure of progress.

Frequently asked questions

Question 3-19: How would an entity account for a partial termination of a contract (e.g., a change in the contract term from three years to two years prior to the beginning of year two)?

See response to Question 3-9 in section 3.2.

Question 3-20: How would an entity account for a contract modification that decreases the scope of a contract?

A modification that decreases the scope of a contract is not accounted for as a separate contract because it does not result in the addition of distinct goods or services (see section 3.4.2). The accounting will depend on whether the remaining goods and services to be provided after the contract modification are distinct from the goods and services already provided. If the remaining goods and services are distinct, the contract modification is accounted for as a termination of the old contract and the creation of a new contract (i.e., prospectively). If the remaining goods and services are not distinct, the contract modification is accounted for as if it were part of the original contract (i.e., cumulative catch-up). See Question 3-9 in section 3.2 regarding a partial termination of a contract.

Furthermore, to modify a contract, a customer may agree to pay a fee. We believe that such a fee is additional consideration that needs to be included in the modified transaction price and allocated to the remaining goods and services to be provided to the customer.

Consider the following example:

Illustration 3-7 — Contract modification that decreases the scope of the promised goods or services in a contract

Entity X enters into a non-cancellable contract with a customer to provide information technology (IT) outsourcing services continuously for a three-year period. Entity X determines that the arrangement contains a single performance obligation comprising a series of distinct services that is transferred to the customer over time. Entity X bills the customer a fixed price of CU500 per month (i.e., the total consideration is CU18,000).

At the end of the second year, Entity X and the customer modify the contract to remove certain discrete services from the overall outsourcing service. As part of the modification, the customer agrees to pay a contract modification fee of CU500 and reduce the monthly payments to CU400 per month.

The services provided after the contract modification are distinct from those provided before the contract modification. This is because the performance obligation is a series of distinct services. Accordingly, Entity X applies the requirements in IFRS 15.21(a) and accounts for the modification prospectively. The remaining consideration of CU5,300 (CU4,800 for the services to be provided in the third year, plus the CU500 payment upon modification) is recognised over the remaining contract period of one year. That is, Entity X recognises the CU500 contract modification fee over the remaining performance period.

Frequently asked questions (cont'd)

Question 3-21: How would an entity account for a 'blend-and-extend' contract modification?

A 'blend-and-extend' contract modification typically is one in which an entity, in exchange for a customer extending the term of the contract (and, therefore, purchasing additional units of a good or service), agrees to decrease the price per unit for all units to be provided (i.e., the new units, as well as the remaining units on the existing contract), resulting in a new blended price per unit. These types of contracts often occur in the power and utilities industry when market prices for the good or service decline after contract inception.

These arrangements are subject to the contract modification requirements in IFRS 15. Since these arrangements typically include the addition of distinct goods or services, the next step is for entities to evaluate whether the additional distinct goods or services are added at their stand-alone selling price in order to determine the accounting for the contract modification (i.e., as a separate contract or as a termination of the existing contract and the creation of a new contract).

When making this evaluation, stakeholders have questioned whether an entity should compare the blended contractual cash selling price or the overall contract price increase to the stand-alone selling price of the additional promised goods or services. We believe that entities should establish an approach based on the facts and circumstances of their modifications and apply that approach consistently to similar fact patterns.

Consider the following example:

Illustration 3-8 — Blend-and-extend contract modification

Entity N enters into a four-year non-cancellable contract with Customer A to provide 100,000 widgets per year at a fixed price of CU10 per widget. Each widget is a distinct good transferred at a point in time.

At the end of the second year, Entity N and Customer A modify the contract to extend the term of the contract by another two years (i.e., Entity N will continue to provide 100,00 widgets in years 5 and 6). The stand-alone selling price of the widget has declined and is now CU8 per widget. As part of the modification, Entity N agrees to reduce the price to a blended rate of CU9 per widget (CU10 in years 3 and 4 and CU8 in years 5 and 6) in exchange for Customer A extending the contract term.

Entity N determines that each widget provided after the modification date is distinct from the widgets provided before the modification date.

Approach A – Compare the overall contract price increase to the stand-alone selling price of the additional promised goods or services

Since the price of the contract increases by an amount of consideration that reflects the stand-alone selling prices of the additional widgets (i.e., CU8 per widget in years 5 and 6), Entity N determines that the contract modification is accounted for as a separate contract in accordance with IFRS 15.20. Entity N will continue to recognise revenue of CU10 per widget for the remaining period in the initial contract (i.e., years 3 and 4) and recognise revenue of CU8 per widget in years 5 and 6.

Frequently asked questions (cont'd)

Illustration 3-8 — Blend-and-extend contract modification (cont'd)

Approach B – Compare the blended contractual cash selling price to the stand-alone selling price of the additional promised goods or services

Since the blended price of CU9 per widget does not reflect the stand-alone selling price of widgets at the modification date (i.e., CU8 per widget), Entity N applies the requirements in IFRS 15.21(a) and accounts for the modification as if it were a termination of the original contract and the creation of a new contract. Total consideration of CU3,600,000 (CU2,000,000 for the widgets to be provided the years 3 and 4, plus CU1,600,000 for the widgets to be provided in years 5 and 6) is allocated to each of the remaining widgets to be provided (400,000 widgets). Entity N will recognise revenue for each widget at a blended rate of CU9 per widget (CU3,600,000 ÷ 400,000 widgets).

The accounting will be different in contract modifications where an entity determines that the remaining goods or services to be provided after the modification date are not distinct from those goods or services provided before the modification date.

There is no presumption that such contract modifications contain a financing component that would be required to be accounted for separately. That is, the mere act of blending the rate in connection with a contract extension in which the customer pays more cash consideration for the same amount of goods or services at the beginning of the contract than the end of the contract does not automatically create a financing. However, each contract's facts and circumstances would need to be evaluated to determine whether a significant financing component exists (see section 5.5 for further discussion on significant financing components).

Question 3-22: How would an entity account for a contract asset that exists when a contract is modified if the modification is treated as the termination of an existing contract and the creation of a new contract? [FASB TRG meeting 18 April 2016 - Agenda paper no. 51]

See response to Question 10-5 in section 10.1.

3.5 Arrangements that do not meet the definition of a contract under the standard (updated October 2018)

If an arrangement does not meet the criteria to be considered a contract under the standard, it must be accounted for as follows:

Extract from IFRS 15

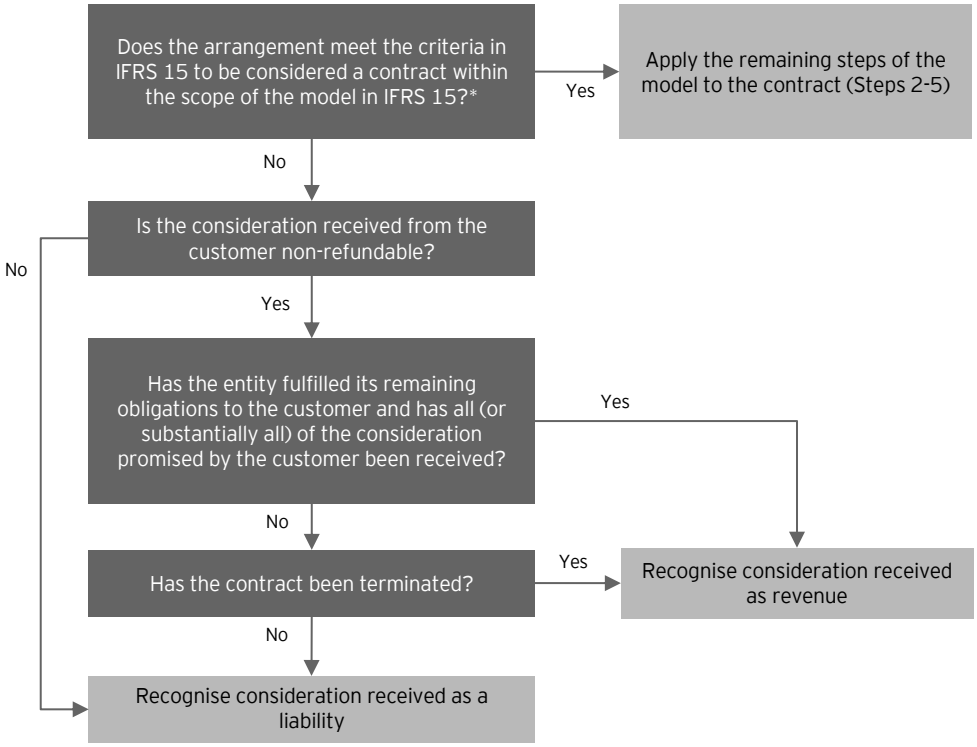
15. When a contract with a customer does not meet the criteria in paragraph 9 and an entity receives consideration from the customer, the entity shall recognise the consideration received as revenue only when either of the following events has occurred:

(a) the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or

(b) the contract has been terminated and the consideration received from the customer is non-refundable.

16. An entity shall recognise the consideration received from a customer as a liability until one of the events in paragraph 15 occurs or until the criteria in paragraph 9 are subsequently met (see paragraph 14). Depending on the facts and circumstances relating to the contract, the liability recognised represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer.

The following flow chart illustrates this requirement:



* Entities need to continue to assess the criteria throughout the term of the arrangement to determine whether they are subsequently met.

Entities are required to continue to assess the criteria in IFRS 15.9 (as discussed in section 3.1) throughout the term of the arrangement to determine whether they are subsequently met. Once the criteria are met, the model in the standard applies, rather than the requirements discussed below. If an entity determines that the criteria in IFRS 15.9 are subsequently met, revenue is recognised on a cumulative catch-up basis as at the date when a contract exists within the scope of the model (i.e., at the 'contract establishment date', reflecting the performance obligations that are partially, or fully, satisfied at that date. This accounting is consistent with the discussion in TRG agenda paper no. 33, which states that the cumulative catch-up method "best satisfies the core principle" in IFRS 15.2.[90] See Question 7-18 in section 7.1.4.C for further discussion).

If an arrangement does not meet the criteria in IFRS 15.9 (and until the criteria are met), an entity only recognises non-refundable consideration received as revenue when one of the events outlined above has occurred (i.e., full performance and all (or substantially all) consideration received or the contract has been terminated) or the arrangement subsequently meets the criteria in IFRS 15.9.

Until one of these events happens, any consideration received from the customer is initially accounted for as a liability (not revenue) and the liability is measured at the amount of consideration received from the customer.

In the Basis for Conclusions, the Board indicated that it intended this accounting to be "similar to the 'deposit method' that was previously included in US GAAP and applied when there was no consummation of a sale".[91] As noted in the Basis for Conclusions, the Board decided to include the requirements in IFRS 15.14-16 to prevent entities from seeking alternative guidance or improperly analogising to the five-step revenue recognition model in IFRS 15 in circumstances in which an executed contract does not meet the criteria in IFRS 15.9.[92]

FASB differences

Under the FASB's standard, when the arrangement does not meet the criteria to be accounted for as a revenue contract under the standard, an entity can also recognise revenue (at the amount of the non-refundable consideration received) when the entity has transferred control of the goods or services and has stopped transferring (and has no obligation to transfer) additional goods or services.

IFRS 15 does not include a similar requirement. However, the IASB states in the Basis for Conclusions on IFRS 15 that contracts often specify that an entity has a right to terminate the contract in the event of non-payment. Furthermore, such clauses would not generally affect the entity's legal rights to recover any amounts due. Therefore, the IASB concluded that the requirements in IFRS 15 would allow an entity to conclude that a contract is terminated when it stops providing goods or services to the customer.[93]

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[90] TRG Agenda paper no. 33, *Partial Satisfaction of Performance Obligations Prior to Identifying the Contract*, dated 30 March 2015.
[91] IFRS 15.BC48.
[92] IFRS 15.BC47.
[93] IFRS 15.BC46H.

Frequently asked questions

Question 3-23: When is a contract considered terminated for purposes of applying IFRS 15.15(b)?

Determining whether a contract is terminated may require significant judgement.

In the Basis for Conclusions on IFRS 15, "the IASB noted that contracts often specify that an entity has the right to terminate the contract in the event of non-payment by the customer and that this would not generally affect the entity's rights to recover any amounts owed by the customer. The IASB also noted that an entity's decision to stop pursuing collection would not typically affect the entity's rights and the customer's obligations under the contract with respect to the consideration owed by the customer. On this basis, … the existing requirements in IFRS 15 are sufficient for an entity to conclude … that a contract is terminated when it stops providing goods or services to the customer."[94]

[94] IFRS 15.BC46H.

4. Identify the performance obligations in the contract

To apply the standard, an entity must identify the promised goods or services within the contract and determine which of those goods or services are separate performance obligations. As noted in the Basis for Conclusions, the Board developed the notion of a 'performance obligation' to assist entities with appropriately identifying the unit of account for the purposes of applying the standard.[95] Because the standard requires entities to allocate the transaction price to performance obligations, identifying the correct unit of account is fundamental to recognising revenue on a basis that faithfully depicts the entity's performance in transferring the promised goods or services to the customer.

The standard provides the following requirements with respect to identifying the performance obligations in a contract:

Extract from IFRS 15

22. At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

(a) a good or service (or a bundle of goods or services) that is distinct; or

(b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 23).

23. A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

(a) each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria in paragraph 35 to be a performance obligation satisfied over time; and

(b) in accordance with paragraphs 39–40, the same method would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

4.1 Identifying the promised goods or services in the contract (updated September 2019)

As a first step in identifying the performance obligation(s) in the contract, the standard requires an entity to identify, at contract inception, the promised goods or services in the contract. The standard provides guidance on the types of items that may be goods or services promised in the contract, as follows:

Extract from IFRS 15

Promises in contracts with customers

24. A contract with a customer generally explicitly states the goods or services that an entity promises to transfer to a customer. However, the

[95] IFRS 15.BC85.

Extract from IFRS 15 (cont'd)

performance obligations identified in a contract with a customer may not be limited to the goods or services that are explicitly stated in that contract. This is because a contract with a customer may also include promises that are implied by an entity's customary business practices, published policies or specific statements if, at the time of entering into the contract, those promises create a valid expectation of the customer that the entity will transfer a good or service to the customer.

25. Performance obligations do not include activities that an entity must undertake to fulfil a contract unless those activities transfer a good or service to a customer. For example, a services provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Therefore, those setup activities are not a performance obligation.

Distinct goods or services

26. Depending on the contract, promised goods or services may include, but are not limited to, the following:

(a) sale of goods produced by an entity (for example, inventory of a manufacturer);

(b) resale of goods purchased by an entity (for example, merchandise of a retailer);

(c) resale of rights to goods or services purchased by an entity (for example, a ticket resold by an entity acting as a principal, as described in paragraphs B34–B38);

(d) performing a contractually agreed-upon task (or tasks) for a customer;

(e) providing a service of standing ready to provide goods or services (for example, unspecified updates to software that are provided on a when-and-if-available basis) or of making goods or services available for a customer to use as and when the customer decides;

(f) providing a service of arranging for another party to transfer goods or services to a customer (for example, acting as an agent of another party, as described in paragraphs B34–B38);

(g) granting rights to goods or services to be provided in the future that a customer can resell or provide to its customer (for example, an entity selling a product to a retailer promises to transfer an additional good or service to an individual who purchases the product from the retailer);

(h) constructing, manufacturing or developing an asset on behalf of a customer;

(i) granting licences (see paragraphs B52–B63B); and

(j) granting options to purchase additional goods or services (when those options provide a customer with a material right, as described in paragraphs B39–B43).

In order for an entity to identify the promised goods or services in a contract, IFRS 15.24 indicates that an entity considers whether there is a valid expectation on the part of the customer that the entity will provide a good or service. If the customer has a valid expectation that it will receive certain goods or services, it is likely that the customer would view those promises as part of the negotiated exchange. This expectation is most commonly created

from an entity's explicit promises in a contract to transfer goods or services to the customer.

However, in other cases, promises to provide goods or services might be implied by the entity's customary business practices or standard industry norms (i.e., outside of the written contract). As discussed in section 3, the Board clarified that, while the contract must be legally enforceable to be within the scope of the revenue model, not all of the promises (explicit or implicit) have to be legally enforceable to be considered when determining the entity's performance obligations.[96] That is, a performance obligation can be based on a customer's valid expectations (e.g., due to the entity's business practice of providing an additional good or service that is not specified in the contract).

In addition, some items commonly considered to be marketing incentives have to be evaluated under IFRS 15 to determine whether they represent promised goods or services in the contract. Such items may include 'free' handsets provided by telecommunication entities, 'free' maintenance provided by automotive manufacturers and customer loyalty points awarded by supermarkets, airlines and hotels.[97] Although an entity may not consider those goods or services to be the 'main' items that the customer contracts to receive, the Board concluded that they are goods or services for which the customer pays and to which the entity would allocate consideration for the purpose of recognising revenue.[98]

IFRS 15.25 states that promised goods or services do *not* include activities that an entity must undertake to fulfil a contract unless those activities transfer control of a good or service to a customer. For example, internal administrative activities that an entity must perform to satisfy its obligation to deliver the promised goods or services, but do not transfer control of a good or service to a customer, would not be promised goods or services. The IFRS IC reiterated this point during its January 2019 meeting (see below for further discussion).

An entity may have to apply judgement when determining whether an activity it will perform is a promised good or service that will be transferred to a customer. The following questions may be relevant for an entity to consider when making this judgement:

- Is the activity identified as a good or service to be provided in the contractual arrangement with the customer? Activities that are not specifically identified could relate to an internal process of the entity, but they could also relate to implicit promises to the customer.
- Does the activity relate to the entity establishing processes and procedures or training its employees, so that it can render the contracted goods or services to the customer (e.g., set-up activities)?
- Is the activity administrative in nature (e.g., tasks performed to determine whether to accept or reject a customer, establishing the customer's account, invoicing the customer)?
- Is the customer aware of when the activity will be performed?

IFRS 15.26 provides examples of promised goods or services that may be included in a contract with a customer. Several of them were considered deliverables under legacy IFRS, including a good produced by an entity or a contractually agreed-upon task (or service) performed for a customer. However, the IASB also included other examples that may not have been considered deliverables in the past. For example, IFRS 15.26(e) describes a

[96] IFRS 15.BC32, BC87.
[97] IFRS 15.BC88.
[98] IFRS 15.BC89.

stand-ready obligation as a promised service that consists of standing ready to provide goods or services or making goods or services available for a customer to use as and when it decides to use it. That is, a stand-ready obligation is the promise that the customer has access to a good or service, rather than a promise to transfer the underlying good or service itself. Stand-ready obligations are common in the software industry (e.g., unspecified updates to software on a when-and-if-available basis) and may be present in other industries. See Questions 4-2 and 4-3 below for further discussion on stand-ready obligations.

IFRS 15.26(g) notes that a promise to a customer may include granting rights to goods or services to be provided in the future that the customer can resell or provide to its own customers. Such a right may represent promises to the customer if it existed at the time that the parties agreed to the contract. As noted in the Basis for Conclusions, the Board thought it was important to clarify that a performance obligation may exist for a promise to provide a good or service in the future (e.g., when an entity makes a promise to provide goods or services to its customer's customer).[99] These types of promises exist in distribution networks in various industries and are common in the automotive industry.

After identifying the promised goods or services in the contract, an entity then determines which of these promised goods or services (or bundle of goods or services) represent separate performance obligations. The standard includes the following example to illustrate how an entity would identify the promised goods or services in a contract (including both explicit and implicit promises). The example also evaluates whether the identified promises are performance obligations, which we discuss in section 4.2:

Extract from IFRS 15

Example 12 — Explicit and implicit promises in a contract (IFRS 15.IE59-IE65A)

An entity, a manufacturer, sells a product to a distributor (ie its customer) who will then resell it to an end customer.

Case A—Explicit promise of service

In the contract with the distributor, the entity promises to provide maintenance services for no additional consideration (ie 'free') to any party (ie the end customer) that purchases the product from the distributor. The entity outsources the performance of the maintenance services to the distributor and pays the distributor an agreed-upon amount for providing those services on the entity's behalf. If the end customer does not use the maintenance services, the entity is not obliged to pay the distributor.

The contract with the customer includes two promised goods or services – (a) the product and (b) the maintenance services. The promise of maintenance services is a promise to transfer goods or services in the future and is part of the negotiated exchange between the entity and the distributor. The entity assesses whether each good or service is distinct in accordance with paragraph 27 of IFRS 15. The entity determines that both the product and the maintenance services meet the criterion in paragraph 27(a) of IFRS 15. The entity regularly sells the product on a stand-alone basis, which indicates that the customer can benefit from the product on its own. The customer can benefit from the maintenance services together with a resource the customer already has obtained from the entity (ie the product).

[99] IFRS 15.BC92.

Extract from IFRS 15 (cont'd)

The entity further determines that its promises to transfer the product and to provide the maintenance services are separately identifiable (in accordance with paragraph 27(b) of IFRS 15) on the basis of the principle and the factors in paragraph 29 of IFRS 15. The product and the maintenance services are not inputs to a combined item in the contract. The entity is not providing a significant integration service because the presence of the product and the services together in this contract do not result in any additional or combined functionality. In addition, neither the product nor the services modify or customise the other. Lastly, the product and the maintenance services are not highly interdependent or highly interrelated because the entity would be able to fulfil each of the promises in the contract independently of its efforts to fulfil the other (ie the entity would be able to transfer the product even if the customer declined maintenance services and would be able to provide maintenance services in relation to products sold previously through other distributors). The entity also observes, in applying the principle in paragraph 29 of IFRS 15, that the entity's promise to provide maintenance is not necessary for the product to continue to provide significant benefit to the customer. Consequently, the entity allocates a portion of the transaction price to each of the two performance obligations (ie the product and the maintenance services) in the contract.

Case B—Implicit promise of service

The entity has historically provided maintenance services for no additional consideration (ie 'free') to end customers that purchase the entity's product from the distributor. The entity does not explicitly promise maintenance services during negotiations with the distributor and the final contract between the entity and the distributor does not specify terms or conditions for those services.

However, on the basis of its customary business practice, the entity determines at contract inception that it has made an implicit promise to provide maintenance services as part of the negotiated exchange with the distributor. That is, the entity's past practices of providing these services create valid expectations of the entity's customers (ie the distributor and end customers) in accordance with paragraph 24 of IFRS 15. Consequently, the entity assesses whether the promise of maintenance services is a performance obligation. For the same reasons as in Case A, the entity determines that the product and maintenance services are separate performance obligations.

Extract from IFRS 15 (cont'd)

Case C—Services are not a promised service

In the contract with the distributor, the entity does not promise to provide any maintenance services. In addition, the entity typically does not provide maintenance services and, therefore, the entity's customary business practices, published policies and specific statements at the time of entering into the contract have not created an implicit promise to provide goods or services to its customers. The entity transfers control of the product to the distributor and, therefore, the contract is completed. However, before the sale to the end customer, the entity makes an offer to provide maintenance services to any party that purchases the product from the distributor for no additional promised consideration.

The promise of maintenance is not included in the contract between the entity and the distributor at contract inception. That is, in accordance with paragraph 24 of IFRS 15, the entity does not explicitly or implicitly promise to provide maintenance services to the distributor or the end customers. Consequently, the entity does not identify the promise to provide maintenance services as a performance obligation. Instead, the obligation to provide maintenance services is accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Although the maintenance services are not a promised service in the current contract, in future contracts with customers the entity would assess whether it has created a business practice resulting in an implied promise to provide maintenance services.

January 2019 IFRS IC discussion

In 2018, the IFRS IC received a request regarding the recognition of revenue by a stock exchange that provides listing services to customers. The request asked whether the stock exchange is providing an admission service that is distinct from an ongoing listing service. At its January 2019 meeting, the IFRS IC concluded that the principles and requirements in IFRS 15 provide sufficient guidance for an entity to assess the promised goods and services in a contract with a customer. Consequently, the IFRS IC decided not to add this matter to its agenda.[100]

In considering this request, the IFRS IC noted that the main question relates to the assessment of the promised goods or services in the contract, rather than the assessment of whether the admission and the listing service are 'distinct' based on IFRS 15.27-30. In their agenda decision, the IFRS IC highlighted that:

- Before identifying its performance obligations, an entity needs to identify the goods and services promised in the contract.[101]
- Performing various tasks (e.g., set-up activities) that do not transfer a good or service to a customer is not a performance obligation – a performance obligation does not include activities that an entity must undertake to fulfil a contract, unless those activities transfer a good or service to a customer.[102]
- If a non-refundable upfront fee relates to an activity that is undertaken at or near contract inception to fulfil the contract, but does not result in transfer of a promised good or service to a customer (i.e., the activities only represent tasks to set up a contract), the fee is an advance payment for future goods or services.[103]

[100] IFRS 15.BC87; *IFRIC Update*, January 2019, available on the IASB's website.
[101] IFRS 15.24; *IFRIC Update*, January 2019, available on the IASB's website.
[102] IFRS 15.25; *IFRIC Update*, January 2019, available on the IASB's website.
[103] IFRS 15.B49; *IFRIC Update*, January 2019, available on the IASB's website.

The IFRS IC discussed what the promised goods and services are in the contract using the following example.[104]

Example of Identification of promised good or service in a contract by a stock exchange that provides listing service to a customer

A stock exchange entity provides its customers with access to the capital markets by admitting them for listing in the stock exchange. The entity charges its customers a non-refundable upfront admission fee and an ongoing listing fee. The non-refundable upfront fee relates to various activities that are undertaken by the entity at or near contract inception to enable admission to the exchange, including:

- Performing due diligence for new applications
- Reviewing the customer's listing application forms, including determining whether the application should be accepted
- Issuing tickers and reference numbers for the new security
- Processing of the listing on, and admission to, the exchange
- Publishing the security on the order book
- Issuing the dealing notice on the applicable admission date

Once the customer has been admitted, the entity provides ongoing market access and maintains the listing. The listing service transferred to the customer is the same on initial listing and on all subsequent days for which the customer remains listed.

As part of identifying the goods and services promised to the customer in the contract, the stock exchange considers whether the above activities undertaken at or near contract inception transfer a service to the customer as the activities are performed. This assessment depends on the facts and circumstances of the contract.

In this fact pattern, the IFRS IC concluded that, while the activities undertaken at or near contract inception are required to fulfil the contract with the customer (which promises to provide the customer with the service of being listed on the exchange), it is likely that the stock exchange would conclude that the activities do not transfer separate services to the customer as they are performed. Accordingly, they are not promised goods or services to be identified under Step 2 of the model.

How we see it

Entities may need to use judgement to identify promised goods or services in a contract. For example, some 'free' goods or services that may seem like marketing incentives have to be evaluated under the standard to determine whether they represent promised goods or services in a contract. In addition, the standard makes it clear that certain activities are not promised goods or services, such as activities that an entity must perform to satisfy its obligation to deliver the promised goods or services (e.g., internal administrative activities).

[104] IFRS IC Agenda paper 3, January 2019, *Assessment of promised goods or services (IFRS 15)*, available on the IASB's website; IFRS IC Agenda paper 2, September 2018, *Assessment of promised goods or services (IFRS 15)* available on the IASB's website; and *IFRIC Update* January 2019, available on the IASB's website.

The Board noted in the Basis for Conclusions that it intentionally "decided not to exempt an entity from accounting for performance obligations that the entity might regard as being perfunctory or inconsequential. Instead, an entity should assess whether those performance obligations are immaterial to its financial statements".[105]

In January 2015, the TRG members noted that entities may not disregard items that they deem to be perfunctory or inconsequential and need to consider whether 'free' goods or services represent promises to a customer. For example, telecommunications entities may have to allocate consideration to the 'free' handsets that they provide. Likewise, automobile manufacturers may have to allocate consideration to 'free' maintenance that may have been considered a marketing incentive in the past. However, entities would consider materiality in determining whether items are promised goods or services.[106]

FASB differences

The FASB's standard allows entities to disregard promises that are deemed to be immaterial in the context of a contract. That is, ASC 606 permits entities to disregard items that are immaterial at the contract level and does not require that the items be aggregated and assessed for materiality at the entity level. However, ASC 606 also emphasises that entities still need to evaluate whether customer options for additional goods or services are material rights to be accounted for in accordance with the related requirements (see section 4.6 below).

IFRS 15 does not include explicit language to indicate an entity can disregard promised goods or services that are immaterial in the context of the contract. However, in the Basis for Conclusions, the IASB noted that it did not intend for entities to identify every possible promised good or services in a contract and that entities should consider materiality and the overall objective of IFRS 15 when assessing promised goods or services and identifying performance obligations.[107]

The FASB's standard also allows entities to elect to account for shipping and handling activities performed after the control of a good has been transferred to the customer as a fulfilment cost (i.e., an expense). Without such an accounting policy choice, a US GAAP entity that has shipping arrangements after the customer has obtained control may determine that the act of shipping is a performance obligation under the standard. If that were the case, the entity would be required to allocate a portion of the transaction price to the shipping service and recognise it when (or as) the shipping occurs.

The IASB has not permitted a similar policy choice in IFRS 15. In the Basis for Conclusions, the IASB noted that IFRS 15.22 requires an entity to assess the goods or services promised in a contract with a customer in order to identify performance obligations. Such a policy choice would override that requirement. Furthermore, a policy choice is applicable to all entities and it is possible that entities with significant shipping operations may make different policy choices. Therefore, it could also reduce comparability between entities, including those within the same industry.[108] Since the

[105] IFRS 15.BC90.
[106] IFRS 15.BC88 and TRG Agenda paper no. 25, *January 2015 Meeting – Summary of Issues Discussed and Next Steps*, dated 30 March 2015.
[107] IFRS 15.BC116D.
[108] IFRS 15.BC116U.

FASB's standard includes a policy choice that IFRS 15 does not, it is possible that diversity between IFRS and US GAAP entities may arise in practice.

Another difference is that FASB uses different language in relation to implied contractual terms and whether those implied terms represent a promised good or service to a customer. IFRS 15 states that promised goods or services are not limited to explicit promises in a contract, but could be created by a 'valid expectation of the customer'. ASC 606 refers to a 'reasonable expectation of the customer'. The FASB used this language in order to avoid confusion with the term 'valid expectation' because ASC 606 states that promises to provide goods or services do not need to be legally enforceable (although the overall arrangement needs to be enforceable). The use of the term 'valid' in IFRS 15 is consistent with the requirements for constructive obligations in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. While the terms used in IFRS 15 and ASC 606 are different, we do not expect this to result in a difference in practice.

Frequently asked questions

Question 4-1: How would an entity assess whether pre-production activities are a promised good or service? [TRG meeting 9 November 2015 – Agenda paper no. 46]

Manufacturing and production entities in various industries had asked the TRG how they should account for activities and costs incurred prior to the production of goods under a long-term supply arrangement when they adopt IFRS 15. The questions arose because some long-term supply arrangements require an entity to incur upfront engineering and design costs to create new technology or adapt existing technology to the needs of the customer.

These pre-production activities are often a prerequisite to delivering any units under a production contract. For example, a manufacturer may incur costs to perform certain services related to the design and development of products it will sell under long-term supply arrangements. It may also incur costs to design and develop moulds, dies and other tools that will be used to produce those products. A contract may require the customer to reimburse the manufacturer for these costs. Alternatively, reimbursement may be implicitly guaranteed as part of the price of the product or by other means.

TRG members generally agreed that the determination of whether pre-production activities are a promised good or service or fulfilment activities requires judgement and consideration of the facts and circumstances. When making this evaluation, entities need to determine whether the activity transfers a good or service to a customer. If an entity determines that these activities are promised goods or services, it applies the requirements in IFRS 15 to those goods or services.

TRG members generally agreed that, if an entity is having difficulty determining whether a pre-production activity is a promised good or service in a contract, the entity needs to consider whether control of that good or service transfers to the customer. For example, if an entity is performing engineering and development services as part of developing a new product for a customer and the customer will own the resulting intellectual property (e.g., patents), it is likely that the entity would conclude that it is transferring control of the intellectual property and that the engineering and development activities are a promised good or service in the contract.

Frequently asked questions (cont'd)

TRG members noted that assessing whether control transfers in such arrangements may be challenging. In some arrangements, legal title of the good or service created from the pre-production activity is transferred to the customer. However, TRG members generally agreed that an entity has to consider all indicators of control transfer under IFRS 15 and that the transfer of legal title is not a presumptive indicator.

The IASB staff noted in the TRG agenda paper that, when an entity is determining whether control transfers to a customer in such arrangements, one of the three over-time revenue recognition criteria may be applicable to pre-production activities. That criterion is whether the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.[109] As further discussed in section 7.1.1, IFRS 15.B3 notes that if an entity cannot readily identify whether this criterion is met, it should consider whether another entity would need to re-perform the work the entity had completed to date if that other entity were required to fulfil the remaining performance obligation.

For example, assume an entity is performing engineering and development as part of developing a new product for a customer. If the entity provided the customer with periodic progress reports in a level of detail that would not require the customer to contract with another entity to re-perform the work, or if the entity were required to provide the customer with the design information completed to date in the case of a termination, it is likely that the entity would conclude that control of that service transfers to the customer as the entity performs.

If a pre-production activity is determined to be a promised good or service, an entity allocates a portion of the transaction price to that good or service (as a single performance obligation or as part of a combined performance obligation that includes the pre-production activities along with other goods or services). If the pre-production activities are included in a performance obligation satisfied over time, they are considered when measuring progress toward satisfaction of that performance obligation (see section 7.1.4).

If a pre-production activity does not result in the transfer of control of a good or service to a customer, an entity should consider other requirements that may be applicable (e.g., IAS 16, IAS 38, IFRS 15.95-98 on costs to fulfil a contract with a customer).

[109] IFRS 15.35(a).

Frequently asked questions (cont'd)

Question 4-2: What is the nature of the promise in a 'typical' stand-ready obligation? [TRG meeting 26 January 2015 – Agenda paper no. 16]

At the January 2015 TRG meeting, members of the TRG discussed numerous examples of stand-ready obligations and generally agreed that the nature of the promise in a stand-ready obligation is the promise that the customer will have access to a good or service, not the delivery of the underlying good or service. The standard describes a stand-ready obligation as a promised service that consists of standing ready to provide goods or services or making goods or services available for a customer to use as and when it decides to do so. Stand-ready obligations are common in the software industry (e.g., unspecified updates to software on a when-and-if-available basis) and may be present in other industries.

The TRG agenda paper included the following types of promises to a customer that could be considered stand-ready obligations, depending on the facts and circumstances:

- Obligations for which the delivery of the good, service or intellectual property is within the control of the entity, but is still being developed (e.g., a software entity's promise to transfer unspecified software upgrades at its discretion)
- Obligations for which the delivery of the underlying good or service is outside the control of the entity and the customer (e.g., an entity's promise to remove snow from an airport runway in exchange for a fixed fee for the year)
- Obligations for which the delivery of the underlying good or service is within the control of the customer (e.g., an entity's promise to provide periodic maintenance on a when-and-if needed basis on a customer's equipment after a pre-established amount of usage by the customer)
- Obligations to make a good or service available to a customer continuously (e.g., a gym membership that provides unlimited access to a customer for a specified period of time)

An entity needs to carefully evaluate the facts and circumstances of its contracts to appropriately identify whether the nature of a promise to a customer is the delivery of the underlying good(s) or service(s) or the service of standing ready to provide goods or services. Entities also have to consider other promises in a contract that includes a stand-ready obligation to appropriately identify the performance obligations in the contract. TRG members generally agreed that all contracts with a stand-ready element do not necessarily include a single performance obligation (refer to Question 4-3 below).[110]

Refer to Question 4-11 in section 4.2.2 for a discussion on whether stand-ready obligations are generally considered to be a series of distinct goods or services.

At the TRG meeting, a FASB staff member also indicated that the staff does not believe that the FASB intended to change previous practice under

[110] TRG Agenda paper no. 48, *Customer options for additional goods and services*, dated 9 November 2015.

Frequently asked questions (cont'd)

US GAAP for determining when software or technology transactions include specified upgrade rights (i.e., a separate performance obligation) or unspecified upgrade rights (i.e., a stand-ready obligation). For details of TRG members' discussion on measuring progress toward satisfaction for a stand-ready obligation that is satisfied over time, see Question 7-13 in section 7.1.4.C.

Question 4-3: Do all contracts with a stand-ready element include a single performance obligation that is satisfied over time? [TRG meeting 9 November 2015 – Agenda paper no. 48]

TRG members generally agreed that the stand-ready element in a contract does not always represent a single performance obligation satisfied over time. This conclusion is consistent with the discussion in Question 4-2 that, when identifying the nature of a promise to a customer, an entity may determine that a stand-ready element exists, but it is not the promised good or service for revenue recognition purposes. Instead, the underlying goods or services are the goods or services promised to the customer and accounted for by the entity.

Consider the following example in the TRG agenda paper:

Example of determining the nature of the promise in a contract with a stand-ready element

An entity is required to stand ready to produce a part for a customer under an MSA. The customer is not obligated to purchase any parts (i.e., there is no minimum guaranteed volume). However, it is highly likely the customer will purchase parts because the part is required to manufacture the customer's product and it is not practical for the customer to buy parts from multiple suppliers. TRG members generally agreed that the nature of the promise in this example is the delivery of the parts, rather than a service of standing ready. When the customer submits a purchase order under the master supply arrangement, it is contracting for a specific number of distinct goods and the purchase order creates new performance obligations for the entity. However, if the entity determined that the nature of the promise is a service of standing ready, the contract would be accounted for as a single performance obligation satisfied over time. In that situation, the entity may be required to estimate the number of purchases to be made throughout the contract term (i.e., make an estimate of variable consideration and apply the constraint on variable consideration) and continually update the transaction price and its allocation among the transferred goods or services.

The TRG agenda paper also noted that, in this example, the entity is not obligated to transfer any parts until the customer submits a purchase order (i.e., the customer makes a separate purchasing decision). This contrasts with a stand-ready obligation, which requires the entity to make a promised service available to the customer and does not require the customer to make any additional purchasing decisions.

See Question 4-17 in section 4.6 for further discussion on determining whether a contract involving variable quantities of goods or services should be accounted for as variable consideration (i.e., if the nature of the promise is to transfer one overall service to the customer, such as a stand-ready obligation) or a contract containing customer options (i.e., if the nature of the promise is to transfer the underlying distinct goods or services).

Frequently asked questions (cont'd)

Question 4-4: How would an entity evaluate whether an exclusivity provision in a contract with customer represents a promised good or service?

We generally believe that an exclusivity provision does not represent a promised good or service. Contracts with customers involving the sale of products or services may contain exclusivity clauses whereby the entity agrees that it will not provide the products or services to others or will do so only on a limited basis. Such provisions may restrict the distribution of the products or services in certain geographical areas and/or prohibit the sale of the products or services to a customer's competitors. For example, an entity that provides advertising on its website may agree to run a banner advertisement for one customer for a specified period of time and exclude advertisements for similar products or services from the advertiser's competitors.

In the Basis for Conclusions on IFRS 15, the IASB discussed exclusivity in relation to licences of intellectual property and concluded that exclusivity is a restriction that represents an attribute of a licence, rather than the nature of the underlying intellectual property or the entity's promise in granting the licence. That is, exclusivity provisions define the scope of the customer's rights to intellectual property and would not be accounted for separately (see section 8.1.3 for further discussion).[111]

We believe that the same principles would apply when evaluating exclusivity provisions in contracts that do not contain a licence of intellectual property. That is, exclusivity is an attribute of the promise to the customer, rather than a separate promised good or service. This is because exclusivity does not change the nature of the entity's performance to provide the underlying goods or services to the customer.

Any upfront payment received from a customer related to an exclusivity provision would need to be evaluated to determine whether it represents a material right (see further discussion in section 5.8). Conversely, any payment made by the entity to the customer would need to be evaluated in accordance with the requirements for consideration paid or payable to a customer (see further discussion in section 5.7).

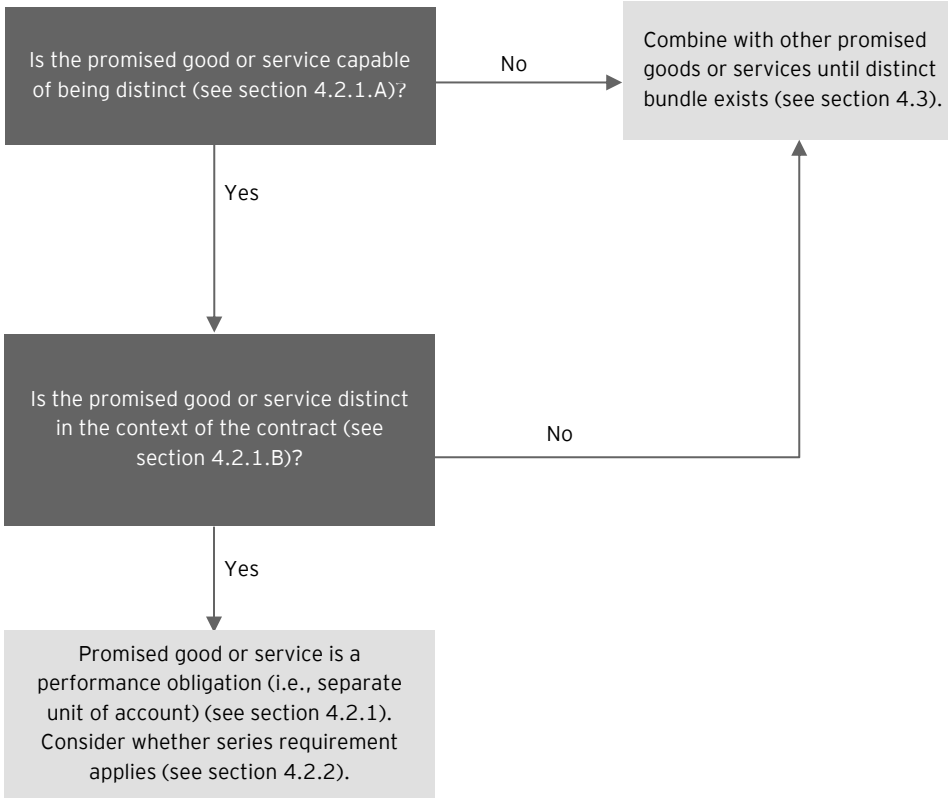
4.2 Determining when promises are performance obligations (updated October 2018)

After identifying the promised goods or services within a contract, an entity determines which of those goods or services will be treated as separate performance obligations. That is, the entity identifies the individual units of account. Promised goods or services represent separate performance obligations if the goods or services are distinct (by themselves, or as part of a bundle of goods or services) (see section 4.2.1) or if the goods or services are part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer (see section 4.2.2).

If a promised good or service is not distinct, an entity is required to combine that good or service with other promised goods or services until it identifies a bundle of goods or services that, together, is distinct. An entity is required to account for all the goods or services promised in a contract as a single performance obligation if the entire bundle of promised goods or services is

[111] IFRS 15.BC412(b).

the only performance obligation identified. See section 4.3 for further discussion. The following flow chart illustrates these requirements:



A single performance obligation may include a licence of intellectual property and other promised goods or services. IFRS 15 identifies two examples of licences of intellectual property that are not distinct from other promised goods or services in a contract: (1) a licence that is a component of a tangible good and that is integral to the functionality of the tangible good; and (2) a licence that the customer can benefit from only in conjunction with a related service (e.g., an online hosting service that enables a customer to access the content provided by the licence of intellectual property).[112] See section 8.1.2 for further discussion on these two examples.

The standard also specifies that the following items are performance obligations:

- Customer options for additional goods or services that provide material rights to customers (see IFRS 15.B40 in section 4.6)
- Service-type warranties (see IFRS 15.B28-B33 in section 9.1)

Entities do not apply the general model to determine whether these goods or services are performance obligations because the Board deemed them to be performance obligations if they are identified as promises in a contract.

[112] IFRS 15.B54.

4.2.1 Determination of 'distinct'

IFRS 15 outlines a two-step process for determining whether a promised good or service (or a bundle of goods or services) is distinct:

- Consideration at the level of the individual good or service of whether the customer can benefit from the good or service on its own or with other readily available resources (i.e., the good or service is capable of being distinct)
- Consideration of whether the good or service is separately identifiable from other promises in the contract (i.e., the promise to transfer the good or service is distinct within the context of the contract)

Both of these criteria must be met to conclude that the good or service is distinct. If these criteria are met, the individual good or service must be accounted for as a separate unit of account (i.e., a performance obligation).

The Board concluded that both steps are important in determining whether a promised good or service should be accounted for separately. The first criterion (i.e., capable of being distinct) establishes the minimum characteristics for a good or service to be accounted for separately. However, even if the individual goods or services promised in a contract may be capable of being distinct, it may not be appropriate to account for each of them separately because doing so would not result in a faithful depiction of the entity's performance in that contract or appropriately represent the nature of an entity's promise to the customer.[113] Therefore, an entity also needs to consider the interrelationship of those goods or services to apply the second criterion (i.e., distinct within the context of the contract) and determine the performance obligations within a contract.

The IFRS IC received a request about the identification of performance obligations in a contract for the sale of a real estate unit that includes the transfer of land, which is discussed below in section 4.2.1.B.

4.2.1.A Capable of being distinct

The first criterion requires that a promised good or service must be capable of being distinct by providing a benefit to the customer either on its own or together with other resources that are readily available to the customer.

The standard provides the following requirements on how to determine whether a promised good or service is capable of being distinct:

Extract from IFRS 15

28. A customer can benefit from a good or service in accordance with paragraph 27(a) if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits. For some goods or services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction with other readily available resources. For example, the fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service on its own or with other readily available resources.

[113] IFRS 15.BC102.

Determining whether a good or service is capable of being distinct is straightforward in many situations. For example, if an entity regularly sells a good or service separately, this fact would demonstrate that the good or service provides benefit to a customer on its own or with other readily available resources.

The evaluation may require more judgement in other situations, particularly when the good or service can only provide benefit to the customer with readily available resources provided by other entities. These are resources that meet either of the following conditions:

- They are sold separately by the entity (or another entity).
- The customer has already obtained them from the entity (including goods or services that the entity has already transferred to the customer under the contract) or from other transactions or events.

As noted in the Basis for Conclusions, the assessment of whether the customer can benefit from the goods or services (either on its own or with other readily available resources) is based on the characteristics of the goods or services themselves, instead of how the customer might use the goods or services.[114] Consistent with this notion, an entity disregards any contractual limitations that may prevent the customer from obtaining readily available resources from a party other than the entity when making this assessment (as illustrated below in Example 11, Case D, extracted in section 4.2.3). The IFRS IC also reiterated this point during its March 2018 meeting (see section 4.2.1.B for further discussion).

In the Basis for Conclusions, the Board explained that "the attributes of being distinct are comparable to the previous revenue recognition requirements for identifying separate deliverables in a multiple-element arrangement, which specified that a delivered item must have 'value to the customer on a stand-alone basis' for an entity to account for that item separately." However, the Board did not use similar terminology in IFRS 15 so as to avoid implying that an entity must assess a customer's intended use for a promised good or service when it is identifying performance obligations. It observed that it would be difficult, if not impossible, for an entity to know a customer's intent.[115]

[114] IFRS 15.BC100.
[115] IFRS 15.BC101.

4.2.1.B Distinct within the context of the contract (updated October 2020)

Once an entity has determined whether a promised good or service is capable of being distinct based on the individual characteristics of the promise, the entity considers the second criterion of whether the good or service is separately identifiable from other promises in the contract (i.e., whether the promise to transfer the good or service is distinct within the context of the contract).

The standard provides the following requirements for making this determination:

Extract from IFRS 15

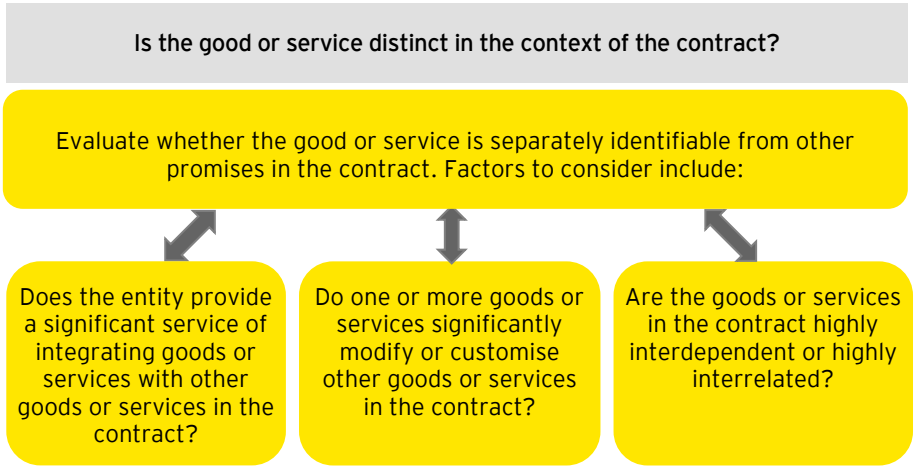
29. In assessing whether an entity's promises to transfer goods or services to the customer are separately identifiable in accordance with paragraph 27(b), the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include, but are not limited to, the following:

(a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit.

(b) one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract.

(c) the goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfil its promise by transferring each of the goods or services independently.

The following illustration depicts the above requirements:



Separately identifiable principle

To determine whether promised goods or services are separately identifiable (i.e., whether a promise to transfer a good or service is distinct within the context of the contract), an entity needs to evaluate whether its promise is to transfer each good or service individually or a combined item (or items) that comprises the individual goods or services promised in the contract. Therefore, an entity would evaluate whether the promised goods or services in the contract are outputs or they are inputs to a combined item (or items). In the Basis for Conclusions, the Board noted that, in many cases, a combined item (or items) is more than (or substantially different from) the sum of the underlying promised goods or services.[116]

The evaluation of whether an entity's promise is separately identifiable considers the relationship between the various goods or services in the context of the process to fulfil the contract. Therefore, an entity considers the level of integration, interrelation or interdependence among the promises to transfer goods or services. In the Basis for Conclusions, the Board observed that, rather than considering whether one item, by its nature, depends on the other (i.e., whether two items have a functional relationship), an entity evaluates whether there is a transformative relationship between the two or more items in the process of fulfilling the contract.[117] The point was also reiterated by the IFRS IC during its March 2018 meeting (see the discussion below).

The Board also emphasised that the separately identifiable principle is applied within the context of the bundle of promised goods or services in the contract. It is not within the context of each individual promised good or service. That is, the separately identifiable principle is intended to identify when an entity's performance in transferring a bundle of goods or services in a contract is fulfilling a single promise to a customer. Therefore, to apply the 'separately identifiable' principle, an entity evaluates whether two or more promised goods or services significantly affect each other in the contract (and are, therefore, highly interdependent or highly interrelated).[118]

As an example of this evaluation, the IASB discussed in the Basis for Conclusions a typical construction contract that involves transferring to the customer many goods or services that are capable of being distinct (e.g., various building materials, labour, project management services). In this example, the IASB concluded that identifying all of the individual goods or services as separate performance obligations would be impractical and would not faithfully represent the nature of the entity's promise to the customer. That is, the entity would recognise revenue when the materials and other inputs to the construction process are provided rather than when it performs (and uses those inputs) in the construction of the item the customer has contracted to receive (e.g., a building, a house). As such, when determining whether a promised good or service is distinct, an entity not only determines whether the good or service is capable of being distinct but also whether the promise to transfer the good or service is distinct within the context of the contract.[119]

IFRS 15.29 includes three factors (discussed individually below) that are intended to help entities identify when the promises in a bundle of promised goods or services are not separately identifiable and, therefore, need to be combined into a single performance obligation. In the Basis for Conclusions, the IASB noted that these three factors are not an exhaustive list and that not all of the factors need to exist in order to conclude that the entity's promises to transfer goods or services are not separately identifiable. As emphasised by the IFRS IC during its March 2018 meeting (see the discussion below), the three

[116] IFRS 15.BC116J.
[117] IFRS 15.BC116K.
[118] IFRS 15.BC116L.
[119] IFRS 15.BC102.

factors also are not intended to be criteria that are evaluated independently of the separately identifiable principle. Given the wide variety of arrangements that are within the scope of IFRS 15, the Board expects that there are some instances in which the factors are less relevant to the evaluation of the separately identifiable principle.[120] Entities may need to apply significant judgement to evaluate whether a promised good or service is separately identifiable. The evaluation requires a thorough understanding of the facts and circumstances present in each contract. An entity should consider the following questions, which summarise what is discussed in the Basis for Conclusions:[121]

- Is the combined item greater than, or substantively different from, the sum of the promised goods or services?
- Is an entity, in substance, fulfilling a single promise to the customer?
- Is the risk an entity assumes to fulfil its obligation to transfer a promised good or service inseparable from the risk relating to the transfer of the other promised goods or services in the bundle?
- Do two or more promised goods or services each significantly affect the other?
- Does each promised good or service significantly affect the other promised good or service's utility to the customer?

In a speech, an SEC staff member focused on considerations for determining whether a promise to transfer a good or service to a customer is separately identifiable from other promises in the contract, which could require significant judgement, as noted above. The SEC staff member emphasised the importance of supporting a registrant's conclusions by providing a well-reasoned analysis of the guidance in the revenue standard, rather than just referring to the manner in which the goods and services are sold to customers. The SEC staff member stated that the SEC staff are not persuaded that promises should be combined into a single performance obligation simply because they are provided as part of a 'solution'. Instead, they expect registrants to provide a robust assessment of the requirements in the revenue standard to support an assertion that the promises to transfer goods are not separately identifiable.

To illustrate this, the SEC staff member described a consultation with the Office of the Chief Accountant (OCA) in which the staff did not object to a registrant's conclusion that software and software updates represent a combined performance obligation. The registrant was able to demonstrate that the software updates were integral to maintaining the utility of the software. That is, without the software updates, the customer's ability to benefit from the software would be significantly limited over the contract term. Based on this point and other facts and circumstances, the registrant was able to demonstrate that the combined output was greater than, or substantively different from, the individual promises of the software and software updates.[122]

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[120] IFRS 15.BC116N.
[121] IFRS 15.BC116J-BC116L.
[122] Remarks by Susan M. Mercier, Professional Accounting Fellow, SEC Office of the Chief Accountant, 9 December 2019, SEC.gov.

Significant integration service

The first factor (included in IFRS 15.29(a)) is the presence of a significant integration service. The IASB determined that, when an entity provides a significant service of integrating a good or service with other goods or services in a contract, the bundle of integrated goods or services represents a combined output or outputs. In other words, when an entity provides a significant integration service, the risk of transferring individual goods or services is inseparable from the bundle of integrated goods or services because a substantial part of an entity's promise to the customer is to make sure the individual goods or services are incorporated into the combined output or outputs.[123] When evaluating this factor, entities need to consider whether they are providing a significant integration service that effectively *transforms* the individual promised goods or services (the inputs) into a combined output(s), as discussed in Example 11, Case E (included in section 4.2.3 below). This is consistent with the notion discussed above that a combined item (or items) would be greater than (or substantially different from) the sum of the underlying promised goods or services.

This factor applies even if there is more than one output. Furthermore, as described in the standard, a combined output or outputs may include more than one phase, element or unit.

In the Basis for Conclusions, the IASB noted that this factor may be relevant in many construction contracts in which a contractor provides an integration (or contract management) service to manage and coordinate the various construction tasks and to assume the risks associated with the integration of those tasks. An integration service provided by the contractor often includes coordinating the activities performed by any subcontractors and making sure the quality of the work performed is in compliance with contract specifications and that the individual goods or services are appropriately integrated into the combined item that the customer has contracted to receive.[124] This type of construction contract and the analysis of whether it contains a significant integration service is illustrated in Example 10, Case A (included in section 4.2.3 below) and in the illustration below.

Illustration 4-1 — Significant integration service

Contractor Q, a construction firm, enters into a contract with a customer to design and construct a concert hall. The project has two phases, design and construction and the contract provides separate compensation for each phase.

For purposes of this example, assume that the individual goods and services provided in each phase are capable of being distinct. Contractor Q must then determine whether each of the individual goods and services in each phase are distinct in the context of the contract. Contractor Q provides a significant service of: (1) integrating the various design services to produce project plans in the design phase; and (2) integrating the various materials and construction services to build the concert hall in the construction phase. Contractor Q then evaluates whether the aggregated goods and services in the design phase (i.e., project plans) and aggregated goods and services in the construction phase (i.e., concert hall) are distinct in the context of the contract and, therefore, are two performance obligations or whether together they represent a single performance obligation.

[123] IFRS 15.BC107.
[124] IFRS 15.BC107.

Illustration 4-1 — Significant integration service (cont'd)

In this illustration, the design and construction of a concert hall is necessary to satisfy Contractor Q's contract with the customer. Given the complex nature of the project, assume Contractor Q will be required to frequently alter the design of the concert hall during construction and to continually assess the propriety of the materials to be used. These changes may cause Contractor Q to rework the construction of the concert hall. Contractor Q determines it is providing a significant service of integrating goods and services into the combined output for which the customer has contracted (i.e., a completed concert hall). Contractor Q concludes that the design services and construction services are not distinct in the context of the contract and instead should be combined and accounted for as one performance obligation.

The Board observed that this factor could apply to other industries as well.[125] In a speech, a member of the SEC staff described a consultation with the OCA in which an entity concluded that it was providing a significant integration service that transformed equipment (e.g., cameras, sensors) and monitoring services into a combined output (i.e., a 'smart' security solution) that provided its customers with an overall service offering that was greater than the customer could receive from each individual promise. In this consultation, OCA did not object to the entity's conclusion that its promises comprised a single performance obligation.[126]

Significant modification or customisation

The second factor in IFRS 15.29(b) is the presence of significant modification or customisation. In the Basis for Conclusions, the IASB explained that in some industries, the notion of inseparable risks is more clearly illustrated by assessing whether one good or service significantly modifies or customises another. This is because if a good or service modifies or customises another good or service in a contract, each good or service is being assembled together (as an input) to produce a combined output.[127]

In the Basis for Conclusions on IFRS 15, the Board provided the following example:[128]

Example of significant customisation service

Assume that an entity promises to provide a customer with software that it will significantly customise to make the software function with the customer's existing infrastructure. Based on the facts and circumstances, the entity determines that it is providing the customer with a fully integrated system and that the customisation service requires it to significantly modify the software in such a way that the risks of providing it and the customisation service are inseparable (i.e., the software and customisation service are not separately identifiable).

The *significance* of modification or customisation services can affect an entity's conclusion about the number of identified performance obligations for similar fact patterns. Consider Example 11, Case A, and Example 11, Case B, in the standard (included in section 4.2.3 below). In Case A, each of the promised goods or services are determined to be distinct because the installation services

[125] IFRS 15.BC108.
[126] Remarks by Sheri L. York, Professional Accounting Fellow, SEC Office of the Chief Accountant, 10 December 2018, SEC.gov.
[127] IFRS 15.BC109.
[128] IFRS 15.BC110.

being provided to the customer do not significantly modify the software. In Case B, two of the promised goods or services are combined into one performance obligation because one promise (the installation) significantly customises another promise (the software).

Highly interdependent or highly interrelated

The third factor in IFRS 15.29(c) is whether the promised goods or services are highly interdependent or highly interrelated. This is often the most difficult distinct factor for entities to assess and it is expected to be an area of focus for entities and their stakeholders. Promised goods or services are highly interdependent or highly interrelated if each of the promised goods or services is significantly affected by one or more of the other goods or services in the contract. As discussed above, the Board clarified that an entity would evaluate how two or more promised goods or services affect each other and not just evaluate whether one item, by its nature, depends on the other. That is, an entity needs to evaluate whether there is a *significant* two-way dependency or transformative relationship between the promised goods or services to determine whether the promises are highly interdependent or highly interrelated. Determining whether a two-way dependency is significant such that the promises are highly interdependent or highly interrelated with each other is a judgement that requires careful consideration.

In the Basis for Conclusions on IFRS 15, the Board provided the following example.[129]

Example of highly interdependent and highly interrelated
An entity promises to design an experimental new product for a customer and to manufacture ten prototype units of that product. Because the product and manufacturing process is unproven, the entity is required to continue to revise the design of the product during the construction and test of the prototypes and make any necessary modifications to in-progress or completed prototypes. The entity expects that most, or all, of the units to be produced will require some rework because of design changes made during the production process. That is, the customer is not likely to be able to choose whether to purchase only the design service or the manufacturing service without one significantly affecting the other. The entity determines that the design and manufacturing promises are highly interdependent on, and highly interrelated with, the other promises in the contract. Consequently, although each promise may provide a benefit on its own, the promises are not separately identifiable within the context of the contract. Conversely, if the design was similar to that of a previous product and/or the entity did not expect to have to rework the prototypes due to design changes, the entity might determine that the two promises are not highly interdependent or highly interrelated and might conclude the contract contains multiple performance obligations.

Goods or services may not be separately identifiable if they are so highly interdependent, on or highly interrelated with, other goods or services under the contract. This may occur when the customer's decision not to purchase one promised good or service would significantly affect the other promised goods or services. In other words, the promised goods or services are so highly interrelated or highly interdependent with each other that the entity could not fulfil an individual promise independently from the other promises in the contract.

[129] IFRS 15.BC112.

One aspect on which this evaluation should focus is the specific utility that can only be delivered through the combination of the goods or services. That is, it is important to establish that the utility each good or service can provide on its own is significantly less than the utility of the combined goods or services. Often, gaining sufficient understanding of the specific utility of the individual goods or services, as well as the combined offering, may involve discussion with employees from various departments (e.g., engineering, sales), in addition to those in the accounting and finance departments. An entity also needs to consider how its products and services are described in publicly available information (e.g., the entity's website, investor relations reports, financial statement filings). Those descriptions may indicate which functionalities are critical to the overall offering and influence customer expectations and whether those functionalities significantly affect the utility of other goods or services in the contract. Overall, the specific facts and circumstances of each offering and contract have to be carefully considered.

The concept regarding an entity's ability to separately fulfil a promise to a customer is highlighted in Example 11, Case E, (included in section 4.2.3 below) in the standard. Example 11, Case E, includes a contract for the sale of equipment and specialised consumables to be used with the equipment. In this example, the entity determines that the equipment and consumables are not highly interdependent or highly interrelated because the two promises do not significantly affect each other. As part of its analysis, the entity concludes that it would be able to fulfil each of its promises in the contract independently of the other promises.

March 2018 IFRS IC discussion

In 2017, the IFRS IC received a request regarding the identification of performance obligations in a contract for the sale of a real estate unit that includes the transfer of land. The request also asked about the timing of revenue recognition for each performance obligation (either over-time or at a point in time), which is discussed in Question 7-10 in section 7.1.3. At its March 2018 meeting, the IFRS IC concluded that the principles and requirements in IFRS 15 provide sufficient guidance for an entity to recognise revenue in a contract for the sale of a real estate unit that includes the transfer of land. Consequently, the IFRS IC decided not to add this matter to its agenda.[130]

In considering this request, the IFRS IC noted that the assessment of the distinct criteria requires judgement. Furthermore:

- The assessment of the first criterion is "based on the characteristics of the goods or services themselves. Accordingly, an entity disregards any contractual limitations that might preclude the customer from obtaining readily available resources from a source other than the entity" (see section 4.2.1.A).[131]
- The objective underlying the second criterion is to determine the nature of the promise within the context of the contract. That is, whether the entity has promised to transfer either the promised goods or services individually or a combined item to which those goods or services are inputs. IFRS 15 also includes some factors that indicate that two or more promises to transfer goods or services are not separately identifiable.[132] However, these factors are not intended to be criteria that an entity evaluates independently of the 'separately identifiable' principle because, in some

[130] *IFRIC Update*, March 2018, available on the IASB's website.
[131] IFRS 15.BC100; *IFRIC Update*, March 2018, available on the IASB's website.
[132] IFRS 15.29; *IFRIC Update*, March 2018, available on the IASB's website.

instances, one or more of the factors may be less relevant to the evaluation of that principle (see section 4.2.1.B).[133]

In the Basis for Conclusion, the Board indicated that the separately identifiable concept is influenced by the idea of separable risks. That is, whether the risk assumed to fulfil the obligation to transfer one of the promised goods or services to the customer is separable from the risk relating to the transfer of the other promised goods or services). Evaluating whether an entity's promise is separately identifiable considers the interrelationship between the goods or services within the contract in the context of the process to fulfil the contract. Accordingly, an entity considers the level of integration, interrelation or interdependence among the promises in the contract to transfer goods or services. An entity evaluates whether, in the process of fulfilling the contract, there is a transformative relationship between the promises, rather than considering whether one item, by its nature, depends upon another (i.e., whether the promises have a functional relationship).[134] That is, the conclusion about whether the promised goods or services are separately identifiable hinges on whether there is a *significant two-way dependency* between the items. Determining whether a two-way dependency is significant such that the promises are separately identifiable is a judgement that requires careful consideration.

The IFRS IC discussed the identification of performance obligations in its March 2018 meeting using the following example from the IFRS IC agenda paper:[135]

Example of identification of performance obligations in a contract for the sale of a real estate unit that includes the transfer of land

Entity A enters into a non-cancellable contract with a customer for the sale of a real estate unit that involves the transfer of a plot of land and a building that Entity A constructs on that land. The land represents all of the area on which the building will be constructed and the contract is for the entire building.

At contract inception, Entity A transfers the legal title of the land and the customer pays the price specified in the contract for it. The transfer of legal title to the customer cannot be revoked, regardless of what happens during the construction of the building. Throughout the construction period, the customer makes milestone payments that do not necessarily correspond to the amount of work completed to date.

The design and specification of the building were agreed between the counterparties before the contract was signed. However, during the construction of the building, the customer can request changes to the design and specification that are priced by Entity A based on a methodology specified in the contract. If the customer decides to proceed with the proposed changes, Entity A can reject them only for a limited number of reasons (e.g., when the change would breach planning permission). Entity A can only request changes if not doing so would lead to an unreasonable increase in costs or delay construction. However, the customer must approve those changes.

Entity A first assesses whether the land and the building are each capable of being distinct in accordance with IFRS 15.27(a). Entity A determines that the customer could benefit from the land on its own or together with other

[133] IFRS 15.BC116N; *IFRIC Update*, March 2018, available on the IASB's website.
[134] IFRS 15.BC105, 116J and 116K.
[135] IFRS IC Agenda paper 2D, March 2018, *Revenue recognition in a real estate contract that includes the transfer of land (IFRS 15)*, available on the IASB's website; *IFRIC Update*, March 2018, available on the IASB's website.

Example of identification of performance obligations in a contract for the sale of a real estate unit that includes the transfer of land (cont'd)

resources readily available to it (e.g., by hiring another developer to construct a building on the land). Also, Entity A determines that the customer could benefit from the construction of the building on its own or together with other resources readily available to it (e.g., by obtaining the construction services from Entity A or another developer without transferring the land). Therefore, Entity A concludes that the land and the building are each capable of being distinct.

The criterion in paragraph 27(b) is then assessed by Entity A in order to determine whether the land and the building are distinct in the context of the contract. In making this assessment, Entity A considers the factors in IFRS 15.29, including the following:

a. Whether it provides a significant service of integrating the land and the building into a combined output. Entity A analyses the transformative relationship between the transfer of the land and the construction of the building in the process of fulfilling the contract. As part of this analysis, it considers whether its performance in constructing the building would be different if it did not also transfer the land and vice versa. Despite the functional relationship between the land and the building (because the building cannot exist without the land on which its foundations will be built), the risks assumed by Entity A in transferring the land may, or may not, be separable from those assumed in constructing the building.

b. Whether the land and the building are highly interdependent or highly interrelated. Entity A determines whether its promise to transfer the land could be fulfilled if it did not also construct the building and vice versa.

The IFRS IC concluded that the two promises would be separately identifiable if Entity A concluded that "(a) its performance in constructing the building would be the same regardless of whether it also transferred the land; and (b) it would be able to fulfil its promise to construct the building even if it did not also transfer the land, and would be able to fulfil its promise to transfer the land even if it did not also construct the building."[136]

Examples

The IASB included a number of examples in the standard that illustrate the application of the requirements for identifying performance obligations. The examples include analysis of how an entity may determine whether the promises to transfer goods or services are distinct within the context of the contract. Refer to section 4.2.3 below for full extracts of several of these examples.

How we see it

The assessment of whether a good or service is distinct must consider the specific contract with a customer. That is, an entity cannot assume that a particular good or service is distinct (or not distinct) in all instances. The manner in which promised goods or services are bundled within a contract can affect the conclusion of whether a good or service is distinct. As a result, entities may account the same goods or services differently, depending on how those goods or services are bundled within a contract.

[136] *IFRIC Update*, March 2018, available on the IASB's website.

Frequently asked questions

Question 4-5: How should an entity determine whether 'connected' hardware sold with cloud services represent one or more performance obligations?

To identify performance obligations in contracts containing connected hardware and cloud services, entities must determine whether the hardware and cloud services are each capable of being distinct and whether they are distinct within the context of the contract (as discussed in section 4.2.1 above). An increasing number of connected hardware devices are now available (e.g., security cameras, home equipment). In contracts where a customer purchases hardware, the hardware may require the installation of an app or the purchase of a cloud service subscription in order to be used. Alternatively, the hardware may provide additional functionalities when paired with the cloud service.

In evaluating the distinct criteria, entities need to consider: whether the hardware can be used without the cloud service; how the hardware and cloud service affect each other (e.g., whether the cloud service enables the hardware to 'learn' or perform its intended function better over time); whether there are additional functionalities that result from using the hardware with the cloud service; and other details of how the hardware and cloud services function and are sold.

Consider the following example where an entity concludes that the connected hardware and cloud services are separately identifiable:

Illustration 4-2: Hardware sold with cloud services

Entity L enters into a contract with a customer to provide a smart home security camera bundled with cloud services, which enable the customer to view live images from the camera in an app on internet-connected devices (e.g., tablets, phones). Entity L also provides the cloud services to customers who purchase the camera through secondary markets.

Entity L concludes that the customer can benefit from each of the goods and services either on its own or together with other goods or services that are readily available. That is, each good or service is capable of being distinct under IFRS 15.27(a).

The camera is capable of being distinct because the customer can benefit from it together with the cloud services, which are a readily available resource since they can be obtained separately. Furthermore, the customer can benefit from the camera because it can be resold through secondary markets for more than scrap value.

The cloud services are capable of being distinct because the customer can benefit from them together with the camera transferred at the outset of the contract or the customer can purchase the camera separately through the secondary markets and obtain the cloud services from the entity.

Entity L then considers the factors in IFRS 15.29 and determines that the promise to transfer each good and service is distinct within the context of the contract. In reaching this conclusion, the entity notes that it does not provide a significant service of integrating the cloud services with the camera into a combined output, and the cloud services and the camera do not significantly modify or customise one another.

Entity L also determines that the camera and the cloud services are not highly interdependent or highly interrelated because it can fulfil its promise to transfer the cloud services independently from its promise to provide the camera (i.e., since customers can purchase the camera in secondary markets).

Frequently asked questions (cont'd)

Illustration 4-2: Hardware sold with cloud services (cont'd)

The cloud services provide only the basic functionality of connecting the camera to a personal device using Wi-Fi (instead of a traditional electrical cable). Therefore, the utility the customer can derive from the camera and the cloud services (when transferred together) is not greater than, or substantially different from, the utility the customer would receive if the camera and cloud services had been transferred separately.

As a result, Entity L identifies two performance obligations: the camera and the cloud services.

Entities will need to evaluate the specific features and functionality of the cloud services in arrangements that include connected hardware devices. Evaluating whether hardware and cloud services are separate performance obligations in arrangements for connected devices may be complex and require significant judgement when the cloud service has sophisticated features or functionality that the device cannot do independently. In these cases, there may be a high degree of interdependency between the hardware and the cloud service or a significant integration service may be present.

How we see it

To conclude that hardware and a cloud service are a single performance obligation, entities will need to demonstrate that the functionality of both the hardware and the service is significantly elevated when they are used together. Many technology entities have concluded that they have separate performance obligations because the hardware and the cloud service do not significantly affect each other and because the hardware can be sold separately from the cloud service.

Question 4-6: How would entities determine whether implementation services are distinct?

Entities will need to assess their implementation services and consider all relevant facts and circumstances to determine whether they are separate performance obligations (i.e., they are capable of being distinct and are distinct within the context of a contract, as discussed in section 4.2.1 above). Entities may include promises to provide implementation services to customers as part of their product or service contracts (i.e., the implementation activities have been determined to transfer a service to the customer, as discussed in section 4.1). For example, these services may include training of customer personnel and data conversion.

When assessing whether implementation services are capable of being distinct, an entity first considers whether the customer can benefit from those services on their own. There is strong evidence to suggest that implementation services are capable of being distinct if third party vendors offer (or are capable of offering) implementation services for the entity's products or services, or if the customer could perform these services on its own. This evidence would demonstrate that the implementation services provide benefit to the customer on their own (i.e., apart from the other promised products or services purchased from the entity).

Frequently asked questions (cont'd)

If an entity concludes that the customer is not able to benefit from the implementation services on their own, the entity considers whether the customer can benefit from the services together with other readily available resources. Readily available resources include the other promised products or services from the contract if they are sold separately by the entity or if they are transferred to the customer before the implementation services. An entity disregards any contractual limitations that prevent the customer from obtaining readily available resources from a party other than the entity when making this assessment. That is, contractually restricting a customer from using another vendor to perform the installation services would not preclude an entity from determining that the implementation services are capable of being distinct.

In assessing whether the implementation services are distinct within the context of the contract, an entity needs to consider whether: the implementation services modify or customise the other promised products or services; the entity is providing a significant service of integrating the promised products or services with the implementation services into one combined output; or the entity would be able to fulfil its promise to transfer the other promised products or services in the contract independently from its promise to provide the implementation services (i.e., whether the implementation services are highly interdependent or interrelated with the other products or services). This evaluation may require judgement and is based on the facts and circumstances of the entity's contracts.

The following illustrations depict implementation services that are distinct and are not distinct, respectively:

Illustration 4-3: Implementation services are distinct

Technology entity P enters into an arrangement with a customer to perform implementation services and to provide software as a service (SaaS) for a three-year period. The entity sells the SaaS and implementation services separately. The implementation services include changing the layout of the main dashboard for each type of user (e.g., marketing, finance) and do not alter the source code of the underlying software or add any new functionality. The implementation service is routinely performed by third parties and does not significantly modify or customise the SaaS.

Technology entity P evaluates the promised goods and services to determine which promises would be accounted for as separate performance obligations.

Technology entity P concludes that the implementation services are capable of being distinct because they can be used with the SaaS, a readily available resource, and because they can be purchased from third parties. Furthermore, the implementation services are distinct within the context of the contract for the following reasons: they are routine; they do not significantly modify or customise the SaaS; they are not integrated with the SaaS into a combined output; and they are not highly interdependent or interrelated with the SaaS since the entity can fulfil its promise to transfer the SaaS independently from its promise to provide the implementation services.

Based on this assessment, Technology entity P identifies two performance obligations: the SaaS and the implementation services.

Frequently asked questions (cont'd)

Illustration 4-4: Implementation services are not distinct

Consider the same promised goods or services as in Illustration 4-3, except that the nature of the implementation services is to set up data feeds and interfaces with third-party applications and to connect the customer's SaaS account to Technology entity P's infrastructure.

Technology entity P does not sell the SaaS without the implementation services, and the customer cannot use the SaaS until the implementation services are complete, which may be up to nine months after entering into a contract. The implementation services cannot be provided by other entities because they require access to Technology entity P's systems.

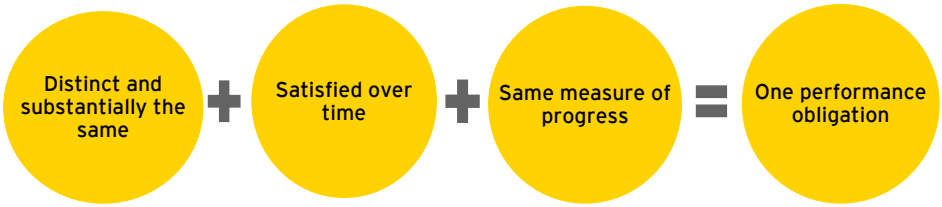
Technology entity P evaluates the promised goods and services to determine which promises would be accounted for as separate performance obligations. The SaaS is capable of being distinct because it can be used together with the implementation services that are provided at the outset of the contract. However, the implementation services are not capable of being distinct because: they are not sold separately by the Technology entity P; they cannot be provided by a third party; and they do not provide benefit to the customer without SaaS (which is not a readily available resource).

Based on this assessment, Technology entity P identifies one performance obligation: the implemented SaaS (comprised of the SaaS and implementation services).

4.2.2 Series of distinct goods or services that are substantially the same and have the same pattern of transfer (updated October 2020)

As discussed above, IFRS 15.22(b) defines, as a second type of performance obligation, a promise to transfer to the customer a series of distinct goods or services that are substantially the same and that have the same pattern of transfer, if both of the following criteria from IFRS 15.23 are met:

- Each distinct good or service in the series that the entity promises to transfer represents a performance obligation that would be satisfied over time, in accordance with IFRS 15.35 (see below and section 7.1), if it were accounted for separately.
- The entity would measure its progress toward satisfaction of the performance obligation using the same measure of progress for each distinct good or service in the series (see section 7.1.4).

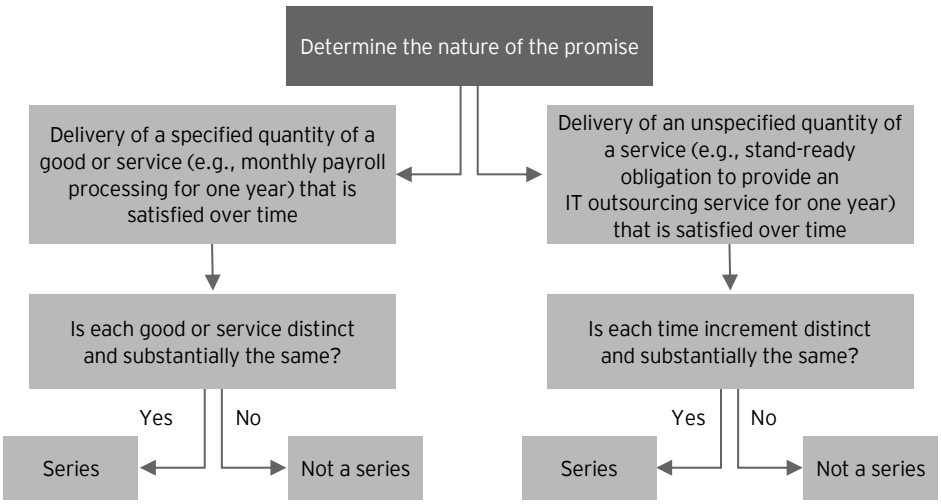


If a series of distinct goods or services meets the criteria in IFRS 15.22(b) and IFRS 15.23 (i.e., the series requirement), an entity is required to treat that series as a single performance obligation (i.e., it is not optional). The Board incorporated this requirement to simplify the model and promote consistent identification of performance obligations in cases when an entity provides the

same good or service over a period of time.[137] Without the series requirement, the Board noted that applying the revenue model might present operational challenges because an entity would have to identify multiple distinct goods or services, allocate the transaction price to each distinct good or service on a stand-alone selling price basis and then recognise revenue when those performance obligations are satisfied. The IASB determined that this would not be cost effective. Instead, an entity identifies a single performance obligation and allocates the transaction price to that performance obligation. It will then recognise revenue by applying a single measure of progress to that performance obligation.[138]

For distinct goods or services to be accounted for as a series, one of the criteria is that they must be substantially the same. This is often the most difficult criterion for entities to assess. In the Basis for Conclusions, the Board provided three examples of repetitive services (i.e., cleaning, transaction processing and delivering electricity) that meet the series requirement.[139] In addition, TRG members generally agreed that when determining whether distinct goods or services are substantially the same, entities need to first determine the nature of their promise. This is because a series could consist of either specified quantities of the underlying good or service delivered (e.g., each unit of a good) or distinct time increments (e.g., an hourly service), depending on the nature of the promise. That is, if the nature of the promise is to deliver a specified quantity of service (e.g., monthly payroll services over a defined contract period), the evaluation considers whether each service is distinct and substantially the same. In contrast, if the nature of the entity's promise is to stand ready or provide a single service for a period of time (i.e., because there is an unspecified quantity to be delivered), the evaluation considers whether each time increment (e.g., hour, day), rather than the underlying activities, is distinct and substantially the same.[140]

The following flow chart illustrates how the determination of the nature of the promise might affect whether the series requirement applies:



[137] IFRS 15.BC113.
[138] IFRS 15.BC114.
[139] IFRS 15.BC114.
[140] TRG Agenda paper no. 39, *Application of the Series Provision and Allocation of Variable Consideration*, dated 13 July 2015.

It is important to highlight that even if the underlying activities an entity performs to satisfy a promise vary significantly throughout the day and from day to day, that fact, by itself, does not mean the distinct goods or services are not substantially the same. Consider an example where the nature of the promise is to provide a daily hotel management service. The service is comprised of activities that may vary each day (e.g., cleaning services, reservation services or property maintenance). However, the entity determines that the daily hotel management services are substantially the same because the nature of the entity's promise is the same each day and the entity is providing the same overall management service each day. See Question 4-9 below for further discussion on determining the nature of an entity's promise and evaluating the substantially the same criterion.

A July 2015 TRG agenda paper explained that, when considering the nature of the entity's promise and the applicability of the series requirement (including whether a good or service is distinct), it may be helpful to consider which over-time criterion in IFRS 15.35 was met (i.e., why the entity concluded that the performance obligation is satisfied over time).[141] As discussed further in section 7.1, a performance obligation is satisfied over time if one of three criteria are met. For example, if a performance obligation is satisfied over time because the customer simultaneously receives and consumes the benefits provided as the entity performs (i.e., the first over-time criterion in IFRS 15.35(a)), that may indicate that each increment of service is capable of being distinct. If that is the case, the entity would need to evaluate whether each increment of service is separately identifiable (and substantially the same). If a performance obligation is satisfied over time based on the other two criteria in IFRS 15.35 (i.e., (1) the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or (2) the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date), the nature of that promise might be to deliver a single specified good or service (e.g., a contract to construct a single piece of equipment), which would not be considered a series because the individual goods or services within that performance obligation are not distinct.

An entity's determination of whether a performance obligation is a single performance obligation comprising a series of distinct goods or services or a single performance obligation comprising goods or services that are not distinct from one another affects the accounting in the following areas: (1) allocation of variable consideration (see section 6.3); (2) contract modifications (see section 3.4); and (3) changes in transaction price (see section 6.5). As the IASB discussed in the Basis for Conclusions, an entity considers the underlying distinct goods or services in the contract, rather than the single performance obligation identified under the series requirement, when applying the requirements for these three areas of the model.[142]

[141] TRG Agenda paper no. 39, *Application of the Series Provision and Allocation of Variable Consideration*, dated 13 July 2015.

[142] IFRS 15.BC115.

The following example, included in a March 2015 TRG agenda paper, illustrates how the allocation of variable consideration may differ for a single performance obligation identified under the series requirement and a single performance obligation comprising non-distinct goods and/or services:[143]

Example of allocation of variable consideration for a series versus a single performance obligation comprising non-distinct goods and/or services

Consider a five-year service contract that includes payment terms of a fixed annual fee plus a performance bonus upon completion of a milestone at the end of year two. If the entire service period is determined to be a single performance obligation comprising a series of distinct services, the entity may be able to conclude that the variable consideration (i.e., the bonus amount) should be allocated directly to its efforts to perform the distinct services up to the date that the milestone is achieved (e.g., the underlying distinct services in years one and two). This could result in the entity recognising the entire bonus amount at the end of year two (when it is highly probable that a significant revenue reversal will not occur). See Question 4-9 for several examples of services for which it would be reasonable to conclude that they meet the series requirement.

In contrast, if the entity determines that the entire service period is a single performance obligation that is comprised of non-distinct services, the bonus would be included in the transaction price (subject to the constraint on variable consideration — see section 5.2.3) and recognised based on the measure of progress determined for the entire service period. For example, assume the bonus becomes part of the transaction price at the end of year two (when it is highly probable that a significant revenue reversal will not occur). In that case, a portion of the bonus would be recognised at that the end of year two based on performance completed to date and a portion would be recognised as the remainder of the performance obligation is satisfied. As a result, the bonus amount would be recognised as revenue through to the end of the five-year service period.

How we see it

We believe that entities may need to apply significant judgement when determining whether a promised good or service in a contract with a customer meets the criteria to be accounted for as a series of distinct goods or services. As illustrated in Question 4-9 below, promised goods or services that meet the series criteria are not limited to a particular industry and can encompass a wide array of promised goods or services.

[143] TRG Agenda paper no. 27, *Series of Distinct Goods or Services*, dated 30 March 2015.

Frequently asked questions

Question 4-7: In order to apply the series requirement, must the goods or services be consecutively transferred? [TRG meeting 30 March 2015 – Agenda paper no. 27]

TRG members generally agreed that a series of distinct goods or services need not be consecutively transferred. That is, the series requirement must be applied even when there is a gap or an overlap in an entity's transfer of goods or services, provided that the other criteria are met. TRG members also noted that entities may need to carefully consider whether the series requirement applies, depending on the length of the gap between an entity's transfer of goods or services.

Stakeholders had asked this question because the Basis for Conclusions uses the term 'consecutively' when it discusses the series requirement.[144] However, the TRG agenda paper concluded that the Board's discussion was not meant to imply that the series requirement only applies to circumstances in which the entity provides the same good or service consecutively over a period of time.

Consider the following example from the TRG agenda paper:

Example of a series in which the goods or services need not be consecutively transferred

An entity has a contract with a customer to provide a manufacturing service producing 24,000 units of a product over a two-year period. The units produced under the service arrangement are distinct, substantially the same and are manufactured to meet the customer's specifications. The entity determines that the service is satisfied over time (see section 7.1) because its performance does not create an asset with alternative use to the entity (i.e., the units are manufactured to specific to the customer). Furthermore, if the contract were to be cancelled, the entity would have an enforceable right to payment (cost plus a reasonable profit margin). Therefore, the criteria for the series requirement in IFRS 15.23 have both been met.

The conclusion in the TRG agenda paper was not influenced by whether the entity would perform the service evenly over the two-year period (e.g., produce 1,000 units per month). That is, the entity could produce 2,000 units in some months and none in others, but this would not be a determining factor in concluding whether the contract met the criteria to be accounted for as a series.

[144] IFRS 15.BC113, BC116.

Frequently asked questions (cont'd)

Question 4-8: In order to apply the series requirement, does the accounting result need to be the same as if the underlying distinct goods or services were accounted for as separate performance obligations? [TRG meeting 30 March 2015 – Agenda paper no. 27]

TRG members generally agreed that the accounting result does not need to be the same. Furthermore, an entity is not required to prove that the result would be the same as if the goods or services were accounted for as separate performance obligations.

Consider the following example from the TRG agenda paper to illustrate this point:

Example of a series for which the accounting result would be different if not treated as a series

An entity contracts with a customer to perform a manufacturing service that results in the production of 10 widgets. The manufacturing service will be performed over a three-year period. The contract price is CU100 million and the stand-alone selling price for each widget is CU10 million.

Total expected costs are CU80 million. The service the entity will provide to the customer in producing each widget is substantially the same. However, the design is new, so the entity expects a decline in production costs over time. Production of the first five units is expected to cost CU9 million per widget. The costs to produce the other five widgets are expected to be CU7 million per widget.

For purposes of this example, the entity determines that each service that it will provide to produce one of the 10 widgets is distinct and meets the criteria to be satisfied over time, and that the same cost-based measure of progress would be used (i.e., the series requirement criteria in IFRS 15.23 are met). The following table demonstrates the difference in accounting between concluding that the series requirement applies and concluding that the contract is for 10 separate performance obligations:

(in CU millions)	Total contract	Series requirement (one performance obligation)		10 separate performance obligations	
		Units 1-5	Units 6-10	Units 1-5	Units 6-10
Revenue	100	56	44	50	50
Cost	80	45	35	45	35
Margin	20	11	9	5	15

Although CU20 million in margin is recognised for the contract under both scenarios, there is a difference in the timing of revenue recognition (and margin) because more revenue is recognised in relation to the service to produce the first five widgets (and less in relation to its service to produce the final five widgets) when the series is accounted for as a single performance obligation using a single measure of progress towards complete satisfaction.

Also see Question 9-14 on how the effect of learning curve costs are addressed in IFRS 15.

Frequently asked questions (cont'd)

Question 4-9: In order to apply the series requirement, how should an entity consider whether a performance obligation consists of distinct goods or services that are 'substantially the same'? [TRG meeting 13 July 2015 – Agenda paper no. 39]

As discussed above, TRG members generally agreed that the TRG paper, which primarily focused on the application of the series requirement to service contracts, will help entities understand how to determine whether a performance obligation consists of distinct goods or services that are 'substantially the same' under IFRS 15.

The TRG agenda paper noted that, when making the evaluation of whether goods or services are distinct and substantially the same, an entity first needs to determine the nature of the entity's promise in providing services to the customer. That is, if the nature of the promise is to deliver a specified quantity of service (e.g., monthly payroll services over a defined contract period), the evaluation should consider whether each service is distinct and substantially the same. In contrast, if the nature of the entity's promise is to stand ready or provide a single service for a period of time (i.e., because there is an unspecified quantity to be delivered), the evaluation would consider whether each time increment (e.g., hour, day), rather than the underlying activities, is distinct and substantially the same. The TRG agenda paper noted that the Board intended that a series could consist of either specified quantities of the underlying good or service delivered (e.g., each unit of a good) or distinct time increments (e.g., an hourly service), depending on the nature of the promise.

As discussed above in section 4.2.2, it is important to highlight that the underlying activities an entity performs to satisfy a performance obligation could vary significantly throughout a day and from day to day. However, the TRG agenda paper noted that this not determinative in the assessment of whether a performance obligation consists of goods or services that are distinct and substantially the same. Consider an example where the nature of the promise is to provide a daily hotel management service. The hotel management service comprises various activities that may vary each day (e.g., cleaning services, reservation services, property maintenance). However, the entity determines that the daily hotel management services are substantially the same because the nature of the entity's promise is the same each day and the entity is providing the same overall management service each day.

The TRG agenda paper included several examples of promised goods or services that may meet the series requirement and the analysis that supports that conclusion. The evaluation of the nature of the promise for each example is consistent with Example 13 of IFRS 15 on monthly payroll processing.

Frequently asked questions (cont'd)

Below we have summarised some of the examples and analysis in the TRG agenda paper.

Example of IT outsourcing

A vendor and customer execute a 10-year IT outsourcing arrangement in which the vendor continuously delivers the outsourced activities over the contract term (e.g., it provides server capacity, manages the customer's software portfolio, runs an IT help desk). The total monthly invoice is calculated based on different units consumed for the respective activities. The vendor concludes that the customer simultaneously receives and consumes the benefits provided by its services as it performs (meeting the over-time criterion in IFRS 15.35(a)).

The vendor first considers the nature of its promise to the customer. Because the vendor has promised to provide an unspecified quantity of activities, rather than a defined number of services, the TRG agenda paper noted that the vendor could reasonably conclude that the nature of the promise is an obligation to stand ready to provide the integrated outsourcing service each day. If the nature of the promise is the overall IT outsourcing service, each day of service could be considered distinct because the customer can benefit from each day of service on its own and each day is separately identifiable. The TRG agenda paper also noted that the vendor could reasonably conclude that each day of service is substantially the same. That is, even if the individual activities that comprise the performance obligation vary from day to day, the nature of the overall promise is the same from day to day. Accordingly, it would be reasonable for an entity to conclude that this contract meets the series requirement.

Example of transaction processing

A vendor enters into a 10-year contract with a customer to provide continuous access to its system and to process all transactions on behalf of the customer. The customer is obliged to use the vendor's system, but the ultimate quantity of transactions is unknown. The vendor concludes that the customer simultaneously receives and consumes the benefits as it performs.

If the vendor concludes that the nature of its promise is to provide continuous access to its system, rather than process a particular quantity of transactions, it might conclude that there is a single performance obligation to stand ready to process as many transactions as the customer requires. If that is the case, the TRG agenda paper noted that it would be reasonable to conclude that there are multiple distinct time increments of the service. Each day of access to the service provided to the customer could be considered substantially the same since the customer is deriving a consistent benefit from the access each day, even if a different number of transactions are processed each day.

Frequently asked questions (cont'd)

Example of transaction processing (cont'd)

If the vendor concludes that the nature of the promise is the processing of each transaction, the TRG agenda paper noted that each transaction processed could be considered substantially the same even if there are multiple types of transactions that generate different payments. Furthermore, the TRG agenda paper noted that each transaction processed could be a distinct service because the customer could benefit from each transaction on its own and each transaction could be separately identifiable. Accordingly, it would be reasonable for an entity to conclude that this contract meets the series requirement.

Example of hotel management

A hotel manager (HM) enters into a 20-year contract to manage properties on behalf of a customer. HM receives monthly consideration of 1% of the monthly rental revenue, as well as reimbursement of labour costs incurred to perform the service and an annual incentive payment. HM concludes that the customer simultaneously receives and consumes the benefits of its services as it performs.

HM considers the nature of its promise to the customer. If the nature of its promise is the overall management service (because the underlying activities are not distinct from each other), the TRG agenda paper noted that each day of service could be considered distinct because the customer can benefit from each day of service on its own and each day of service is separately identifiable.

Assuming the nature of the promise is the overall management service, the TRG agenda paper noted that the service performed each day could be considered distinct and substantially the same. This is because, even if the individual activities that comprise the performance obligation vary significantly throughout the day and from day to day, the nature of the overall promise to provide the management service is the same from day to day. Accordingly, it would be reasonable for an entity to conclude that this contract meets the series requirement.

The following is another example of promised goods and services that may meet the series requirement and the analysis that supports that conclusion:

Illustration 4-5: Determining whether promised goods and services represent a series

A SaaS provider enters into a three-year contract with Customer X to provide access to its SaaS basic customer relationship management (CRM) application for CU300,000. The contract also includes professional services that will personalise the user's interface based on the user's role. These services are sold separately from the CRM application and can be provided by third party vendors. The customer can benefit from the CRM application without the professional services, which do not significantly customise or modify the CRM application.

Frequently asked questions (cont'd)

Illustration 4-5: Identifying whether promised goods and services represent a series (cont'd)

The SaaS provider determines that the CRM application and professional services are distinct (i.e., the CRM application and the professional services should not be combined into a single performance obligation). The two services are each capable of being distinct because Customer X can benefit from them on their own. The services are distinct within the context of the contract because they are not highly interdependent or interrelated and each service does not significantly modify or customise the other.

The SaaS provider first determines that the nature of the CRM application promise is to provide continuous access to its CRM application for the three-year period. Although the activities that Customer X may be able to perform via the CRM application may vary from day to day, the overall promise is to provide continuous access to the CRM application to Customer X for a period of three years.

The SaaS provider determines that access to the CRM application represents a series of distinct services that are substantially the same and have the same pattern of transfer to Customer X. Each day of service is capable of being distinct because Customer X benefits each day from access to the CRM application. Each day is distinct within the context of the contract because there are no significant integration services, each day does not modify or customise another day and each day is not highly interdependent or interrelated. Each day of service is substantially the same because Customer X derives a consistent benefit from the access to the CRM application and has the same pattern of transfer over the term of the contract. Each distinct service represents a performance obligation that is satisfied over time and has the same measure of progress (e.g., time-elapsed). Therefore, the criteria to account for access to the CRM application as a series of distinct services (i.e., a single performance obligation) are met.

The SaaS provider also considers whether the professional services meet the criteria to be accounted for as a series. As part of this assessment, the entity considers whether each day of the professional services is distinct from the other days or whether the nature of the promise for the professional services is for a combined output from all of the days. The entity also considers the complexity of the professional services and whether the activity of each day builds on one another or if each day is substantially the same. This analysis requires judgement and is based on the facts and circumstances of the professional services performed.

Question 4-10: Can an entity choose whether to apply the series requirement?

No. As discussed above, if a series of distinct goods or services meets the criteria in IFRS 15.22(b) and 23, an entity is required to treat that series as a single performance obligation (i.e., it is not an optional requirement).

Frequently asked questions (cont'd)

Question 4-11: Do all stand-ready obligations meet the criteria to be accounted for as a series?

We generally believe that stand-ready obligations will meet the criteria and, therefore, need to be accounted for as a series of distinct goods or services. As discussed in Questions 4-2 and 4-3 in section 4.1, entities may need to apply judgement to determine whether the nature of a promise to a customer is the service of standing ready to provide goods or services (i.e., a stand-ready obligation) or the delivery of the underlying goods or services (i.e., not a stand-ready obligation).

4.2.3 Examples of identifying performance obligations

The standard includes several examples that illustrate the application of the requirements for identifying performance obligations. The examples explain the judgements made to determine whether the promises to transfer goods or services are capable of being distinct and distinct within the context of the contract. We have extracted these examples below.

The following example illustrates contracts with promised goods or services that, while capable of being distinct, are not distinct within the context of the contract because of a significant integration service that combines the inputs (the underlying goods or services) into a combined output:

Extract from IFRS 15

Example 10 — Goods and services are not distinct (IFRS 15.IE45-IE48C)

Case A—Significant integration service

An entity, a contractor, enters into a contract to build a hospital for a customer. The entity is responsible for the overall management of the project and identifies various promised goods and services, including engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment and finishing.

The promised goods and services are capable of being distinct in accordance with paragraph 27(a) of IFRS 15. That is, the customer can benefit from the goods and services either on their own or together with other readily available resources. This is evidenced by the fact that the entity, or competitors of the entity, regularly sells many of these goods and services separately to other customers. In addition, the customer could generate economic benefit from the individual goods and services by using, consuming, selling or holding those goods or services.

However, the promises to transfer the goods and services are not separately identifiable in accordance with paragraph 27(b) of IFRS 15 (on the basis of the factors in paragraph 29 of IFRS 15). This is evidenced by the fact that the entity provides a significant service of integrating the goods and services (the inputs) into the hospital (the combined output) for which the customer has contracted.

Because both criteria in paragraph 27 of IFRS 15 are not met, the goods and services are not distinct. The entity accounts for all of the goods and services in the contract as a single performance obligation.

Extract from IFRS 15 (cont'd)

Case B—Significant integration service

An entity enters into a contract with a customer that will result in the delivery of multiple units of a highly complex, specialised device. The terms of the contract require the entity to establish a manufacturing process in order to produce the contracted units. The specifications are unique to the customer, based on a custom design that is owned by the customer and that were developed under the terms of a separate contract that is not part of the current negotiated exchange. The entity is responsible for the overall management of the contract, which requires the performance and integration of various activities including procurement of materials, identifying and managing subcontractors, and performing manufacturing, assembly and testing.

The entity assesses the promises in the contract and determines that each of the promised devices is capable of being distinct in accordance with paragraph 27(a) of IFRS 15 because the customer can benefit from each device on its own. This is because each unit can function independently of the other units.

The entity observes that the nature of its promise is to establish and provide a service of producing the full complement of devices for which the customer has contracted in accordance with the customer's specifications. The entity considers that it is responsible for overall management of the contract and for providing a significant service of integrating various goods and services (the inputs) into its overall service and the resulting devices (the combined output) and, therefore, the devices and the various promised goods and services inherent in producing those devices are not separately identifiable in accordance with paragraph 27(b) and paragraph 29 of IFRS 15. In this case, the manufacturing process provided by the entity is specific to its contract with the customer. In addition, the nature of the entity's performance and, in particular, the significant integration service of the various activities means that a change in one of the entity's activities to produce the devices has a significant effect on the other activities required to produce the highly complex, specialised devices such that the entity's activities are highly interdependent and highly interrelated. Because the criterion in paragraph 27(b) of IFRS 15 is not met, the goods and services that will be provided by the entity are not separately identifiable and, therefore, are not distinct. The entity accounts for all of the goods and services promised in the contract as a single performance obligation.

The determination of whether a 'significant integration service' exists within a contract, as illustrated in Case A and Case B above, requires significant judgement and is heavily dependent on the unique facts and circumstances for each individual contract with a customer.

The following example illustrates how the significance of installation services can affect an entity's conclusion about the number of identified performance obligations for similar fact patterns. In Case A, each of the promised goods and services are determined to be distinct. In Case B, two of the promised goods and services are combined into a single performance obligation because one promise (the installation) significantly customises another promise (the software).

Extract from IFRS 15

Example 11 — Determining whether goods or services are distinct (IFRS 15.IE49-IE58)

Case A—Distinct goods or services

An entity, a software developer, enters into a contract with a customer to transfer a software licence, perform an installation service and provide unspecified software updates and technical support (online and telephone) for a two-year period. The entity sells the licence, installation service and technical support separately. The installation service includes changing the web screen for each type of user (for example, marketing, inventory management and information technology). The installation service is routinely performed by other entities and does not significantly modify the software. The software remains functional without the updates and the technical support.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of IFRS 15. The entity observes that the software is delivered before the other goods and services and remains functional without the updates and the technical support. The customer can benefit from the updates together with the software licence transferred at the start of the contract. Thus, the entity concludes that the customer can benefit from each of the goods and services either on their own or together with the other goods and services that are readily available and the criterion in paragraph 27(a) of IFRS 15 is met.

The entity also considers the principle and the factors in paragraph 29 of IFRS 15 and determines that the promise to transfer each good and service to the customer is separately identifiable from each of the other promises (thus the criterion in paragraph 27(b) of IFRS 15 is met). In reaching this determination, the entity considers that, although it integrates the software into the customer's system, the installation services do not significantly affect the customer's ability to use and benefit from the software licence because the installation services are routine and can be obtained from alternative providers. The software updates do not significantly affect the customer's ability to use and benefit from the software licence during the licence period. The entity further observes that none of the promised goods or services significantly modify or customise one another, nor is the entity providing a significant service of integrating the software and the services into a combined output. Lastly, the entity concludes that the software and the services do not significantly affect each other and, therefore, are not highly interdependent or highly interrelated, because the entity would be able to fulfil its promise to transfer the initial software licence independently from its promise to subsequently provide the installation service, software updates or technical support.

On the basis of this assessment, the entity identifies four performance obligations in the contract for the following goods or services:

(a) the software licence;

(b) an installation service;

(c) software updates; and

(d) technical support.

Extract from IFRS 15 (cont'd)

The entity applies paragraphs 31–38 of IFRS 15 to determine whether each of the performance obligations for the installation service, software updates and technical support are satisfied at a point in time or over time. The entity also assesses the nature of the entity's promise to transfer the software licence in accordance with paragraph B58 of IFRS 15 (see Example 54 in paragraphs IE276–IE277).

Case B—Significant customisation

The promised goods and services are the same as in Case A, except that the contract specifies that, as part of the installation service, the software is to be substantially customised to add significant new functionality to enable the software to interface with other customised software applications used by the customer. The customised installation service can be provided by other entities.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of IFRS 15. The entity first assesses whether the criterion in paragraph 27(a) has been met. For the same reasons as in Case A, the entity determines that the software licence, installation, software updates and technical support each meet that criterion. The entity next assesses whether the criterion in paragraph 27(b) has been met by evaluating the principle and the factors in paragraph 29 of IFRS 15. The entity observes that the terms of the contract result in a promise to provide a significant service of integrating the licenced software into the existing software system by performing a customised installation service as specified in the contract. In other words, the entity is using the licence and the customised installation service as inputs to produce the combined output (ie a functional and integrated software system) specified in the contract (see paragraph 29(a) of IFRS 15). The software is significantly modified and customised by the service (see paragraph 29(b) of IFRS 15). Consequently, the entity determines that the promise to transfer the licence is not separately identifiable from the customised installation service and, therefore, the criterion in paragraph 27(b) of IFRS 15 is not met. Thus, the software licence and the customised installation service are not distinct.

On the basis of the same analysis as in Case A, the entity concludes that the software updates and technical support are distinct from the other promises in the contract.

On the basis of this assessment, the entity identifies three performance obligations in the contract for the following goods or services:

(a) software customisation (which comprises the licence for the software and the customised installation service);

(b) software updates; and

(c) technical support.

The entity applies paragraphs 31–38 of IFRS 15 to determine whether each performance obligation is satisfied at a point in time or over time.

The following examples illustrate contracts that include multiple promised goods or services, all of which are determined to be distinct. The examples highlight the importance of considering both the separately identifiable principle and the underlying factors in IFRS 15.29.

Case C illustrates a contract that includes the sale of equipment and installation services. The equipment can be operated without any customisation or modification. The installation is not complex and can be performed by other entities. The entity determines that the two promises in the contract are distinct.

Case D illustrates that certain types of contractual restrictions, including those that require a customer to only use the entity's services, should not affect the evaluation of whether a promised good or service is distinct.

Case E illustrates a contract that includes the sale of equipment and specialised consumables to be used with the equipment. Even though the consumables can only be produced by the entity, they are sold separately. The entity determines that the two promises in the contract are distinct and the example walks through the analysis for determining whether the promises are capable of being distinct and distinct in the context of the contract. As part of this analysis, the entity concludes that the equipment and consumables are not highly interrelated nor highly interdependent because the two promises do not significantly affect each other. That is, the entity would be able to fulfil each of its promises in the contract independently of the other promises.

Extract from IFRS 15

Example 11 — Determining whether goods or services are distinct (IFRS 15.IE58A-IE58K)

Case C—Promises are separately identifiable (installation)

An entity contracts with a customer to sell a piece of equipment and installation services. The equipment is operational without any customisation or modification. The installation required is not complex and is capable of being performed by several alternative service providers.

The entity identifies two promised goods and services in the contract: (a) equipment and (b) installation. The entity assesses the criteria in paragraph 27 of IFRS 15 to determine whether each promised good or service is distinct. The entity determines that the equipment and the installation each meet the criterion in paragraph 27(a) of IFRS 15. The customer can benefit from the equipment on its own, by using it or reselling it for an amount greater than scrap value, or together with other readily available resources (for example, installation services available from alternative providers). The customer also can benefit from the installation services together with other resources that the customer will already have obtained from the entity (ie the equipment).

The entity further determines that its promises to transfer the equipment and to provide the installation services are each separately identifiable (in accordance with paragraph 27(b) of IFRS 15). The entity considers the principle and the factors in paragraph 29 of IFRS 15 in determining that the equipment and the installation services are not inputs to a combined item in this contract. In this case, each of the factors in paragraph 29 of IFRS 15 contributes to, but is not individually determinative of, the conclusion that the

Extract from IFRS 15 (cont'd)

equipment and the installation services are separately identifiable as follows:

(a) The entity is not providing a significant integration service. That is, the entity has promised to deliver the equipment and then install it; the entity would be able to fulfil its promise to transfer the equipment separately from its promise to subsequently install it. The entity has not promised to combine the equipment and the installation services in a way that would transform them into a combined output.

(b) The entity's installation services will not significantly customise or significantly modify the equipment.

(c) Although the customer can benefit from the installation services only after it has obtained control of the equipment, the installation services do not significantly affect the equipment because the entity would be able to fulfil its promise to transfer the equipment independently of its promise to provide the installation services. Because the equipment and the installation services do not each significantly affect the other, they are not highly interdependent or highly interrelated.

On the basis of this assessment, the entity identifies two performance obligations in the contract for the following goods or services:

(i) the equipment; and

(ii) installation services.

The entity applies paragraphs 31–38 of IFRS 15 to determine whether each performance obligation is satisfied at a point in time or over time.

Case D—Promises are separately identifiable (contractual restrictions)

Assume the same facts as in Case C, except that the customer is contractually required to use the entity's installation services.

The contractual requirement to use the entity's installation services does not change the evaluation of whether the promised goods and services are distinct in this case. This is because the contractual requirement to use the entity's installation services does not change the characteristics of the goods or services themselves, nor does it change the entity's promises to the customer. Although the customer is required to use the entity's installation services, the equipment and the installation services are capable of being distinct (ie they each meet the criterion in paragraph 27(a) of IFRS 15) and the entity's promises to provide the equipment and to provide the installation services are each separately identifiable, ie they each meet the criterion in paragraph 27(b) of IFRS 15. The entity's analysis in this regard is consistent with that in Case C.

Case E—Promises are separately identifiable (consumables)

An entity enters into a contract with a customer to provide a piece of off-the-shelf equipment (ie the equipment is operational without any significant customisation or modification) and to provide specialised consumables for use in the equipment at predetermined intervals over the next three years. The consumables are produced only by the entity, but are sold separately by the entity.

The entity determines that the customer can benefit from the equipment together with the readily available consumables. The consumables are readily available in accordance with paragraph 28 of IFRS 15, because they are

Extract from IFRS 15 (cont'd)

regularly sold separately by the entity (ie through refill orders to customers that previously purchased the equipment). The customer can benefit from the consumables that will be delivered under the contract together with the delivered equipment that is transferred to the customer initially under the contract. Therefore, the equipment and the consumables are each capable of being distinct in accordance with paragraph 27(a) of IFRS 15.

The entity determines that its promises to transfer the equipment and to provide consumables over a three-year period are each separately identifiable in accordance with paragraph 27(b) of IFRS 15. In determining that the equipment and the consumables are not inputs to a combined item in this contract, the entity considers that it is not providing a significant integration service that transforms the equipment and consumables into a combined output. In addition, neither the equipment nor the consumables are significantly customised or modified by the other. Lastly, the entity concludes that the equipment and the consumables are not highly interdependent or highly interrelated because they do not significantly affect each other. Although the customer can benefit from the consumables in this contract only after it has obtained control of the equipment (ie the consumables would have no use without the equipment) and the consumables are required for the equipment to function, the equipment and the consumables do not each significantly affect the other. This is because the entity would be able to fulfil each of its promises in the contract independently of the other. That is, the entity would be able to fulfil its promise to transfer the equipment even if the customer did not purchase any consumables and would be able to fulfil its promise to provide the consumables, even if the customer acquired the equipment separately.

On the basis of this assessment, the entity identifies two performance obligations in the contract for the following goods or services:

(a) the equipment; and

(b) the consumables.

The entity applies paragraphs 31–38 of IFRS 15 to determine whether each performance obligation is satisfied at a point in time or over time.

4.3 Promised goods or services that are not distinct

If a promised good or service does not meet the criteria to be considered distinct, an entity is required to combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that, together, is distinct. This could result in an entity combining a good or service that is not considered distinct with another good or service that, on its own, would meet the criteria to be considered distinct (see section 4.2.1).

The standard provides two examples of contracts with promised goods or services that, while capable of being distinct, are not distinct in the context of the contract because of a significant integration service that combines the inputs (the underlying goods or services) into a combined output. Full extracts of these examples (Example 10, Case A, and Example 10, Case B) are included in section 4.2.3 above.

4.4 Principal versus agent considerations (updated October 2018)

When more than one party is involved in providing goods or services to a customer, the standard requires an entity to determine whether it is a principal or an agent in these transactions by evaluating the nature of its promise to the customer. An entity is a principal (and, therefore, records revenue on a gross basis) if it controls a promised good or service before transferring that good or service to the customer. An entity is an agent (and, therefore, records as revenue the net amount that it retains for its agency services) if its role is to arrange for another entity to provide the goods or services.

In the Basis for Conclusions, the Board explained that in order for an entity to conclude that it is providing the good or service to the customer, it must first control that good or service. That is, the entity cannot provide the good or service to a customer if the entity does not first control it. If an entity controls the good or service, the entity is a principal in the transaction. If an entity does not control the good or service before it is transferred to the customer, the entity is an agent in the transaction.[145]

In the Basis for Conclusions, the Board noted that an entity that itself manufactures a good or performs a service is always a principal if it transfers control of that good or service to another party. There is no need for such an entity to evaluate the principal versus agent application guidance because it transfers control of or provides its own good or service directly to its customer without the involvement of another party. For example, if an entity transfers control of a good to an intermediary that is a principal in providing that good to an end-customer, the entity records revenue as a principal in the sale of the good to its customer (the intermediary).[146]

How we see it

Entities need to carefully evaluate whether they are acting as principal or as an agent. The application guidance in IFRS 15 focuses on control of the specified goods or services as the overarching principle for entities to consider in determining whether they are acting as a principal or an agent. That is, an entity first evaluates whether it controls the specified good or service before reviewing the standard's principal indicators.

[145] IFRS 15.BC385D.
[146] IFRS 15.BC385E.

IFRS 15 states the overall principle for the principal versus agent evaluation, as follows:

Extract from IFRS 15

B34. When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (ie the entity is a principal) or to arrange for those goods or services to be provided by the other party (ie the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer (see paragraphs 27–30). If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others.

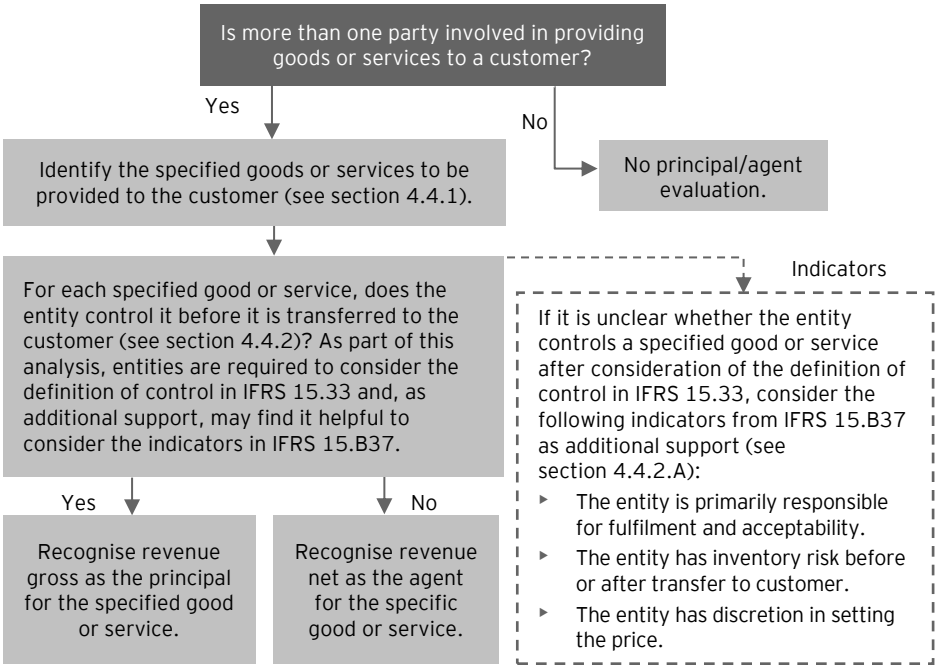
B34A. To determine the nature of its promise (as described in paragraph B34), the entity shall:

(a) identify the specified goods or services to be provided to the customer (which, for example, could be a right to a good or service to be provided by another party (see paragraph 26)); and

(b) assess whether it controls (as described in paragraph 33) each specified good or service before that good or service is transferred to the customer.

B35. An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer. However, an entity does not necessarily control a specified good if the entity obtains legal title to that good only momentarily before legal title is transferred to a customer. An entity that is a principal may satisfy its performance obligation to provide the specified good or service itself or it may engage another party (for example, a subcontractor) to satisfy some or all of the performance obligation on its behalf.

The following flow chart illustrates the process for performing a principal versus agent evaluation:



How we see it

The principal versus agent application guidance applies regardless of the type of transaction under evaluation or the industry in which the entity operates. Entities that: (a) do not stock inventory and may employ independent warehouses or fulfilment houses to drop-ship merchandise to customers on their behalf; or (b) offer services to be provided by an independent service provider (e.g., travel agents, magazine subscription brokers and retailers that sell goods through catalogues or that sell goods on consignment) may need to apply significant judgement when applying this application guidance.

4.4.1 Identifying the specified good or service (updated October 2020)

In accordance with IFRS 15.B34A, an entity must first identify the specified good or service (or unit of account for the principal versus agent evaluation) to be provided to the customer in the contract in order to determine the nature of its promise (i.e., whether it is to provide the specified goods or services or to arrange for those goods or services to be provided by another party). A specified good or service is defined as "a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer".[147] While this definition is similar to that of a performance obligation (see section 4.2), the IASB noted in the Basis for Conclusions that it created this new term because using 'performance obligation' would have been confusing in agency relationships.[148] That is, because an agent's performance obligation is to arrange for goods or services to be provided by another party, providing the specified goods or services to the end-customer is not the agent's performance obligation.

A specified good or service may be a distinct good or service or a distinct bundle of goods or services. In the Basis for Conclusions, the Board noted that if individual goods or services are not distinct from one another, they may be inputs to a combined item and each good or service may represent only a part of a single promise to the customer. For example, in a contract in which goods or services provided by another party are inputs to a combined item (or items), the entity would assess whether it controls the combined item (or items) before that item (or items) is transferred to the customer.[149] That is, in determining whether it is a principal or an agent, an entity should evaluate that single promise to the customer, rather than the individual inputs that make up that promise.

Appropriately identifying the good or service to be provided is a critical step in determining whether an entity is a principal or an agent in a transaction. In many situations, especially those involving tangible goods, identifying the specified good or service is relatively straightforward. For example, if an entity is reselling laptop computers, the specified good that is transferred to the customer is a laptop computer.

However, the assessment may require significant judgement in other situations, such as those involving intangible goods or services. In accordance with IFRS 15.B34A(a), the specified good or service may be the underlying good or service a customer ultimately wants to obtain (e.g., a flight, a meal) or a right to obtain that good or service (e.g., in the form of a ticket or voucher). In the Basis for Conclusions, the Board noted that when the specified good or service is a right to a good or service that will be provided by another party, the entity would determine whether its performance obligation is a promise to provide

[147] IFRS 15.B34.
[148] IFRS 15.BC385B.
[149] IFRS 15.BC385Q.

that right (and it is, therefore, a principal) or whether it is arranging for the other party to provide that right (and it is, therefore, an agent). The fact that the entity does not provide the underlying goods or services itself is not determinative.[150]

The Board acknowledged that it may be difficult in some cases to determine whether the specified good or service is the underlying good or service or a right to obtain that good or service. Therefore, it provided examples in the standard. Example 47 (extracted in full in section 4.4.4) involves an airline ticket reseller. In this example, the entity pre-purchases airline tickets that it will later sell to customers. While the customer ultimately wants airline travel, the conclusion in Example 47 is that the specified good or service is the right to fly on a specified flight (in the form of a ticket) and not the underlying flight itself. The entity itself does not fly the plane and it cannot change the service (e.g., change the flight time or destination). However, the entity obtained the ticket prior to identifying a specific customer to purchase the ticket. As a result, the entity holds an asset (in the form of a ticket) that represents a right to fly. The entity could, therefore, transfer that right to a customer (as depicted in the example) or decide to use the right itself.

Example 46A (extracted in full in section 4.4.4) involves an office maintenance service provider. In this example, the entity concludes that the specified good or service is the underlying office maintenance service (rather than a right to that service). While the entity obtained the contract with the customer prior to engaging a third party to perform the requested services, the right to the subcontractor's services never transfers to the customer. Instead, the entity retains the right to direct the service provider. That is, the entity can direct the right to use the subcontractor's services as it chooses (e.g., to fulfil the customer contract, to fulfil another customer contract, to service its own facilities). Furthermore, the customer in Example 46A is indifferent as to who carries out the office maintenance services. This is not the case in Example 47, in which the customer wants the ticket reseller to sell one of its tickets on a specific flight.

If a contract with a customer includes more than one specified good or service, IFRS 15 clarifies that an entity may be a principal for some specified goods or services and an agent for others.[151] Example 48A in IFRS 15 provides an illustration of this. Also consider the following example:

Illustration 4-6 — Entity is both a principal and an agent

A software reseller sells software licences bundled with PCS and other IT solutions to end-users. The reseller has entered into contracts with several software manufacturers that provide the reseller with the right to sell licences to the software with PCS to end-users during non-cancellable periods of time in exchange for fixed fees per licence sold. The reseller can set the prices it charges end-users, but is contractually required to pay the software manufacturer the fixed fee, regardless of the price paid by end-users. The software reseller does not have a commitment to make a minimum number of purchases from the software manufacturer and does not make purchases in advance.

The software reseller is responsible for identifying which software will address the customer's needs (including the feasibility of integrating it with the customer's existing technology environment), ordering the software from the manufacturer, assisting customers if they encounter issues downloading the software (all software is provided electronically) and with other basic

[150] IFRS 15.BC385O.
[151] IFRS 15.B34.

Illustration 4-6 — Entity is both a principal and an agent (cont'd)

technical support. The software manufacturer provides higher levels of technical support and provides PCS directly to the customer.

As part of its principal-versus-agent evaluation for these contracts, the software reseller determines that the software licence and PCS are separate specified goods or services.

When assessing control for the software licence, the reseller concludes that it controls the software licence before the licence is provided to the end-user. This is because the reseller has the right to direct the software manufacturer to provide the software to the end-user on the reseller's behalf. As part of this assessment, the software reseller also considers the three indicators of control in the standard and makes the following determinations that support its overall control evaluation:

- The software reseller is responsible for fulfilling the promise to the customer and the entity takes responsibility for much of the purchasing process, as described above.
- There is no inventory risk associated with the software provided electronically.
- The software reseller has discretion to establish prices.

Conversely, the reseller concludes that it does not control the PCS before it is provided to the end-user because the software manufacturer creates the updates that it delivers electronically to end-users of the software directly through the internet and all but the most basic level of technical support will be provided by the software manufacturer. As part of this assessment, the software reseller also considers the three indicators of control in the standard and makes the following determinations that support its overall control evaluation:

- The software manufacturer is responsible for fulfilling the promise to the customer because it provides the updates directly to the end-users.
- There is no inventory risk associated with the PCS provided electronically.
- The software reseller has discretion to establish prices.

The software reseller believes that the first of the indicators is the most relevant to consider in this assessment and that it supports its overall control assessment. Therefore, the software reseller concludes that it is the principal for the software licence, but is an agent for the PCS, because it does not control the PCS before it is transferred to the end-user.

How we see it

As discussed above, appropriately identifying the specified good or service to be provided to the customer is a critical step in identifying whether the nature of an entity's promise is to act as a principal or an agent. Entities need to carefully examine their contract terms and may need to apply significant judgement to determine whether the specified good or service is the underlying good or service or a right to obtain that good or service.

4.4.2 Control of the specified good or service (updated October 2020)

In accordance with IFRS 15.B34A, the second step in determining the nature of the entity's promise (i.e., whether it is to provide the specified goods or services or to arrange for those goods or services to be provided by another party) is for the entity to determine whether the entity controls the specified good or service before it is transferred to the customer. An entity cannot provide the specified good or service to a customer (and, therefore, be a principal) unless it controls that good or service prior to its transfer. That is, as the Board noted in the Basis for Conclusions, control is the determining factor when assessing whether an entity is a principal or an agent.[152]

In assessing whether an entity controls the specified good or service prior to transfer to the customer, IFRS 15.B34A(b) requires the entity to consider the definition of control that is included in Step 5 of the model, in accordance with IFRS 15.33 (discussed further in section 7).

Extract from IFRS 15

33. Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

(a) using the asset to produce goods or provide services (including public services);

(b) using the asset to enhance the value of other assets;

(c) using the asset to settle liabilities or reduce expenses;

(d) selling or exchanging the asset;

(e) pledging the asset to secure a loan; and

(f) holding the asset.

When evaluating the definition of control in IFRS 15.33, we believe it could be helpful for entities to consider the indicators in IFRS 15.38 (see section 7.2) that the IASB included to help determine the point in time when a customer obtains control of a particular good or service (e.g., legal title, physical possession, risks and rewards of ownership).

If, after evaluating the requirement in IFRS 15.33, an entity concludes that it controls the specified good or service before it is transferred to the customer, the entity is a principal in the transaction. If the entity does not control that good or service before transfer to the customer, it is an agent.

[152] IFRS 15.BC385S.

Stakeholder feedback indicated that the control principle was easier to apply to tangible goods than to intangible goods or services because intangible goods or services generally exist only at the moment they are delivered. To address this concern, the standard includes application guidance on how the control principle applies to certain types of arrangements (including service transactions) by explaining what a principal controls before the specified good or service is transferred to the customer:

Extract from IFRS 15

B35A. When another party is involved in providing goods or services to a customer, an entity that is a principal obtains control of any one of the following:

(a) a good or another asset from the other party that it then transfers to the customer.

(b) a right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf.

(c) a good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer. For example, if an entity provides a significant service of integrating goods or services (see paragraph 29(a)) provided by another party into the specified good or service for which the customer has contracted, the entity controls the specified good or service before that good or service is transferred to the customer. This is because the entity first obtains control of the inputs to the specified good or service (which includes goods or services from other parties) and directs their use to create the combined output that is the specified good or service.

In the Basis for Conclusions, the Board observed that an entity can control a service to be provided by another party when it controls the right to the specified service that will be provided to the customer.[153] Generally, the entity then either transfers the right (in the form of an asset, such as a ticket) to its customer, in accordance with IFRS 15.B35A(a) (as in Example 47 involving the airline ticket reseller discussed in section 4.4.1) or uses its right to direct the other party to provide the specified service to the customer on the entity's behalf, in accordance with IFRS 15.B35A(b) (as in Example 46A involving the office maintenance services discussed in section 4.4.1).

The condition described in IFRS 15.B35A(a) includes contracts in which an entity transfers to the customer a right to a future service to be provided by another party. If the specified good or service is a right to a good or service to be provided by another party, the entity evaluates whether it controls the right to the goods or services before that right is transferred to the customer (rather than whether it controls the underlying goods or services). In the Basis for Conclusions, the Board noted that, in assessing such rights, it is often relevant to assess whether the right is created only when it is obtained by the customer or whether the right exists before the customer obtains it. If the right does not exist before the customer obtains it, an entity would not be able to control right before it is transferred to the customer.[154]

The standard includes two examples to illustrate this point. In Example 47 (discussed above in section 4.4.1 and extracted in full in section 4.4.4), which involves an airline ticket reseller, the specified good or service is determined to

[153] IFRS 15.BC385U.
[154] IFRS 15.BC385O.

be the right to fly on a specified flight (in the form of a ticket). One of the determining factors for the principal-agent evaluation in this example is that the entity pre-purchases the airline tickets before a specific customer is identified. Accordingly, the right existed prior to a customer obtaining it. The example concludes that the entity controls the right before it is transferred to the customer (and is, therefore, a principal).

In Example 48 (extracted in full in section 4.4.4), an entity sells vouchers that entitle customers to future meals at specified restaurants selected by the customer. The specified good or service is determined to be the right to a meal (in the form of a voucher). One of the determining factors for the principal-agent evaluation is that the entity does not control the voucher (the right to a meal) at any time. It does not pre-purchase or commit itself to purchase the vouchers from the restaurants before they are sold to a customer. Instead, the entity waits to purchase the voucher until a customer requests a voucher for a particular restaurant. In addition, vouchers are created only at the time that they are transferred to a customer and do not exist before that transfer. Accordingly, the right does not exist before the customer obtains it. Therefore, the entity does not at any time have the ability to direct the use of the vouchers or obtain substantially all of the remaining benefits from the vouchers before they are transferred to customers. The example concludes that the entity does not control the right before it is transferred to the customer (and is, therefore, an agent).

In the Basis for Conclusions, the IASB acknowledged that determining whether an entity is a principal or an agent may be more difficult when evaluating whether a contract falls under IFRS 15.B35A(b). That is, it may be difficult to determine whether an entity has the ability to direct another party to provide the service on its behalf (and is, therefore, a principal) or is only arranging for the other party to provide the service (and is, therefore, an agent). As depicted in Example 46A (as discussed in section 4.4.1 and extracted in full in section 4.4.4), an entity could control the right to the specified service and be a principal by entering into a contract with the subcontractor in which the entity defines the scope of service to be performed by the subcontractor on its behalf. This situation is equivalent to the entity fulfilling the contract using its own resources. Furthermore, the entity remains responsible for the satisfactory provision of the specified service in accordance with the contract with the customer. In contrast, when the specified service is provided by another party and the entity does not have the ability to direct those services, the entity typically is an agent because the entity is facilitating, rather than controlling the rights to, the service.[155]

In a speech, a member of the SEC staff described a consultation with OCA regarding a registrant that had performed some of the specified services for its customer, but had fully relied on another service provider for others, due to certain regulatory restrictions. The SEC staff member noted that it was critical to evaluate whether the entity could control the specified services before transferring them to the customer. In this case, the registrant was able to demonstrate that it had the contractual ability to control the other service provider by determining when the service provider delivered the services because the service provider could not contractually deny services to the customer, even though the service provider had discretion in how it fulfilled its obligations. The registrant concluded, and the SEC staff did not object, that the registrant was the principal in the arrangement, based on this analysis and an

[155] IFRS 15.BC385V.

analysis of the other relevant indicators of control (e.g., the registrant was responsible for handling most customer concerns that arose from the services provided by the other service provider).[156]

In accordance with IFRS 15.B35A(c), if an entity provides a significant service of integrating two or more goods or services into a combined item that is the specified good or service the customer contracted to receive, the entity controls that specified good or service before it is transferred to the customer. This is because the entity first obtains control of the inputs to the specified good or service (which can include goods or services from other parties) and directs their use to create the combined item that is the specified good or service. The inputs would be a fulfilment cost to the entity. However, as noted by the Board in the Basis for Conclusions, if a third party provides the significant integration service, the entity's customer for its good or services (which would be inputs to the specified good or service) is likely to be the third party.[157]

4.4.2.A Principal indicators (updated September 2019)

After considering the application guidance discussed above, it still may not be clear whether an entity controls the specified good or service. Therefore, the standard provides three indicators of when an entity controls the specified good or service (and is, therefore, a principal):

Extract from IFRS 15

B37. Indicators that an entity controls the specified good or service before it is transferred to the customer (and is therefore a principal (see paragraph B35)) include, but are not limited to, the following:

(a) the entity is primarily responsible for fulfilling the promise to provide the specified good or service. This typically includes responsibility for the acceptability of the specified good or service (for example, primary responsibility for the good or service meeting customer specifications). If the entity is primarily responsible for fulfilling the promise to provide the specified good or service, this may indicate that the other party involved in providing the specified good or service is acting on the entity's behalf.

(b) the entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (for example, if the customer has a right of return). For example, if the entity obtains, or commits itself to obtain, the specified good or service before obtaining a contract with a customer, that may indicate that the entity has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service before it is transferred to the customer.

(c) the entity has discretion in establishing the price for the specified good or service. Establishing the price that the customer pays for the specified good or service may indicate that the entity has the ability to direct the use of that good or service and obtain substantially all of the remaining benefits. However, an agent can have discretion in establishing prices in some cases. For example, an agent may have some flexibility in setting prices in order to generate additional revenue from its service of arranging for goods or services to be provided by other parties to customers.

[156] Remarks by Lauren K. Alexander, Professional Accounting Fellow, SEC Office of the Chief Accountant, 9 December 2019, SEC.gov.

[157] IFRS 15.BC385R.

The principal indicators above are meant to support an entity's assessment of control, not to replace it. Each indicator explains how it supports the assessment of control. As emphasised in the Basis for Conclusions, the indicators do not override the assessment of control, should not be viewed in isolation and do not constitute a separate or additional evaluation. Furthermore, they should not be considered a checklist of criteria to be met or factors to be considered in all scenarios. IFRS 15.B37A notes that considering one or more of the indicators will often be helpful and, depending on the facts and circumstances, individual indicators will be more or less relevant or persuasive to the assessment of control.[158] If an entity reaches different conclusions about whether it controls the specified good or service by applying the standard's definition of control versus the principal indicators, the entity should re-evaluate its assessment, considering the facts and circumstances of its contract. This is because an entity's conclusions about control and the principal indicators should align.

The first indicator that an entity is a principal, in IFRS 15.B37(a), is that the entity is primarily responsible for fulfilling the promise to provide the specified good or service to the customer, which typically includes responsibility for the acceptability of the specified good or service. We believe that one of the reasons that this indicator supports the assessment of control of the specified good or service is because an entity generally controls a specified good or service that it is responsible for transferring control to a customer.

The terms of the contract and representations (written or otherwise) made by an entity during marketing generally provide evidence of which party is responsible for fulfilling the promise to provide the specified good or service and for the acceptability of that good or service.

It is possible that one entity may not be solely responsible for both providing the specified good or service and for the acceptability of that same good or service. For example, a reseller may sell goods or services that are provided to the customer by a supplier. However, if the customer is dissatisfied with the goods or services it receives, the reseller may be solely responsible for providing a remedy to the customer. The reseller may promote such a role during the marketing process or may agree to such a role as claims arise in order to maintain its relationship with its customer. In this situation, both the reseller and the supplier possess characteristics of this indicator. Therefore, it is likely that other indicators will need to be considered to determine which entity is the principal. However, if the reseller is responsible for providing a remedy to a dissatisfied customer, but can then pursue a claim against the supplier to recoup any remedies it provides, that may indicate that the reseller is not ultimately responsible for the acceptability of the specified good or service.

The second indicator that an entity is a principal, in IFRS 15.B37(b), is that the entity has inventory risk (before the specified good or service is transferred to the customer or upon customer return). Inventory risk is the risk normally taken by an entity that acquires inventory in the hope of reselling it at a profit. Inventory risk exists if a reseller obtains (or commits to obtain) the specified good or service before it is ordered by a customer. Inventory risk also exists if a customer has a right of return and the reseller will take back the specified good or service if the customer exercises that right.

This indicator supports the assessment of control of the specified good or service because when an entity obtains (or commits to obtain) the specified good or service before it has contracted with a customer, it is likely that the entity has the ability to direct the use of and obtain substantially all of the

[158] IFRS 15.BC385H.

remaining benefits from the good or service. For example, inventory risk can exist in a customer arrangement involving the provision of services if an entity is obliged to compensate the individual service provider(s) for work performed, regardless of whether the customer accepts that work. However, this indicator often does not apply to intangible goods or services.

Factors may exist that mitigate a reseller's inventory risk. For example, a reseller's inventory risk may be significantly reduced or eliminated if it has the right to return to the supplier goods it cannot sell or goods that are returned by customers. Another example is if a reseller receives inventory price protection from the supplier. In these cases, the inventory risk indicator may be less relevant or persuasive to the assessment of control.

The third principal indicator, in IFRS 15.B37(c), is that the entity has discretion in establishing the price of the specified good or service. Reasonable latitude, within economic constraints, to establish the price with a customer for the product or service may indicate that the entity has the ability to direct the use of that good or service and obtain substantially all of the remaining benefits (i.e., the entity controls the specified good or service). However, because an agent may also have discretion in establishing the price of the specified good or service, the facts and circumstances of the transaction need to be carefully evaluated.

The illustration below, which is similar to Example 45 in the standard, shows how an entity might conclude that it is an agent:

Illustration 4-7 — Entity is an agent

An entity operates a website that provides a marketplace for customers to purchase goods from a variety of suppliers who deliver the goods directly to the customers. The entity's website facilitates customer payments to suppliers at prices that are set by the suppliers. The entity requires payment from customers before orders are processed and all orders are non-refundable. The entity has no further obligations to the customers after arranging for the products to be provided to them; the entity is not responsible for the acceptability of goods provided to customers.

First, the entity evaluates the specified goods and concludes that there are no other goods or services provided to the customer except for those provided directly by the suppliers. Next, the entity considers whether it controls the specified goods before they are transferred to the customers. Since the entity does not at any time have the ability to direct the use of the goods transferred to the customers, the entity concludes that it does not control the specified goods before they are transferred. As part of this assessment, the entity considers the three indicators of control in the standard and makes the following determinations that support its overall control evaluation:

- The suppliers are responsible for fulfilling the promise to the customer and the entity does not take responsibility for the acceptability of the goods
- The entity does not have inventory risk because it does not obtain the goods at any time
- The entity does not have discretion to establish prices because they are set by the suppliers

The entity concludes that it is an agent for the goods sold through its website because the nature of its performance obligation is to arrange for goods to be provided to the customers.

In contrast, consider the following example of an entity that concludes it is acting as a principal:

Illustration 4-8 — Entity is a principal

An entity operates a website that provides a marketplace for customers to purchase digital content. The entity has entered into contracts with suppliers that provide it with the right to sell the digital content during a non-cancellable period of time in exchange for a fixed fee per unit of content. The entity can set the price for the content to be sold to customers on its website. The entity is contractually required to pay the supplier a fixed price or rate for any digital content it sells to its customers and that price or rate is unaffected by the price paid by the end-customers. The entity is responsible for assisting customers if they encounter issues downloading the content or with the user experience, and customers do not interact with the suppliers.

The entity first evaluates the specified goods and concludes that the digital content is the only specified good or service. Next, the entity considers whether it controls the digital content before it is transferred to the customer. The entity concludes that it controls the specified goods before they are transferred because it has entered into a non-cancellable distribution agreement that permits the entity to sell the digital content to its customers. This conclusion differs from the entity's conclusion in Illustration 4-8 because that entity provided a platform to connect suppliers to customers and did not have the ability to sell the suppliers' goods. As part of this assessment, the entity also considers the three indicators of control in the standard and makes the following determinations that support its overall control evaluation:

- The entity is responsible for fulfilling the promise to the customer and the entity takes responsibility for the acceptability of the digital content
- There is no inventory risk associated with digital content
- The entity has discretion to establish prices

The entity concludes that it is a principal for the digital content sold through its website because it controls the content before it is transferred to the customer.

4.4.3 Recognising revenue as principal or agent (updated October 2018)

The determination of whether the entity is acting as a principal or an agent affects the amount of revenue the entity recognises.

When the entity is the principal in the arrangement, the revenue recognised is the gross amount to which the entity expects to be entitled. When the entity is the agent, the revenue recognised is the net amount that the entity is entitled to retain in return for its services as the agent. The entity's fee or commission may be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

After an entity determines whether it is the principal or the agent and the amount of gross or net revenue that would be recognised, the entity recognises revenue when or as it satisfies its performance obligation. An entity satisfies its performance obligation by transferring control of the specified good or service underlying the performance obligation, either at a point in time or over time (as discussed in section 7). That is, a principal would recognise revenue when (or as) it transfers the specified good or service to the customer. An agent would recognise revenue when its performance obligation to arrange for the specified good or service is complete.

In the Basis for Conclusions, the Board noted that, in some contracts in which the entity is the agent, control of specified goods or services promised by the agent may transfer before the customer receives related goods or services from the principal. For example, an entity might satisfy its promise to provide customers with loyalty points when those points are transferred to the customer if:

- The entity's promise is to provide loyalty points to customers when the customer purchases goods or services from the entity.
- The points entitle the customers to future discounted purchases with another party (i.e., the points represent a material right to a future discount).
- The entity determines that it is an agent (i.e., its promise is to arrange for the customers to be provided with points) and the entity does not control those points (i.e., the specified good or service) before they are transferred to the customer.

In contrast, if the points entitle the customers to future goods or services to be provided by the entity, the entity may conclude it is not an agent. This is because the entity's promise is to provide those future goods or services and, therefore, the entity controls both the points and the future goods or services before they are transferred to the customer. In these cases, the entity's performance obligation may only be satisfied when the future goods or services are provided.

In other cases, the points may entitle customers to choose between future goods or services provided by either the entity or another party. For example, many airlines allow loyalty programme members to redeem loyalty points for goods or services provided by a partner (e.g., travel on another airline, hotel accommodation). In this situation, the nature of the entity's performance obligation may not be known until the customer makes its choice. That is, until the customer has chosen the goods or services to be provided (and, therefore, whether the entity or the third party will provide those goods or services), the entity is obliged to stand ready to deliver goods or services. Therefore, the entity may not satisfy its performance obligation until it either delivers the goods or services or is no longer obliged to stand ready. If the customer subsequently chooses to receive the goods or services from another party, the entity would need to consider whether it was acting as an agent and would, therefore, only recognise revenue for a fee or commission that it received for arranging the ultimate transaction between the customer and the third party.[159]

How we see it

The above discussion illustrates that control of specified goods or services promised by an agent may transfer before the customer receives related goods or services from the principal. An entity needs to assess each loyalty programme in accordance with the principles of the principal versus agent application guidance to determine if revenue would be reported on a gross or net basis.

[159] IFRS 15.BC383-BC385.

Although an entity may be able to transfer its obligation to provide its customer specified goods or services, the standard says that such a transfer may not always satisfy the performance obligation:

Extract from IFRS 15

B38. If another entity assumes the entity's performance obligations and contractual rights in the contract so that the entity is no longer obliged to satisfy the performance obligation to transfer the specified 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 contract for the other party (ie whether the entity is acting as an agent).

4.4.4 Examples of principal versus agent considerations (updated September 2019)

The standard includes six examples to illustrate the principal versus agent application guidance discussed above. We have extracted four of them below.

The standard includes the following example of when the specified good or service (see section 4.4.1) is the underlying service, rather than the right to obtain that service. The entity in this example is determined to be a principal:

Extract from IFRS 15

Example 46A — Promise to provide goods or services (entity is a principal) (IFRS 15.IE238A-IE238G)

An entity enters into a contract with a customer to provide office maintenance services. The entity and the customer define and agree on the scope of the services and negotiate the price. The entity is responsible for ensuring that the services are performed in accordance with the terms and conditions in the contract. The entity invoices the customer for the agreed-upon price on a monthly basis with 10-day payment terms.

The entity regularly engages third-party service providers to provide office maintenance services to its customers. When the entity obtains a contract from a customer, the entity enters into a contract with one of those service providers, directing the service provider to perform office maintenance services for the customer. The payment terms in the contracts with the service providers are generally aligned with the payment terms in the entity's contracts with customers. However, the entity is obliged to pay the service provider even if the customer fails to pay.

To determine whether the entity is a principal or an agent, the entity identifies the specified good or service to be provided to the customer and assesses whether it controls that good or service before the good or service is transferred to the customer.

Extract from IFRS 15 (cont'd)

The entity observes that the specified services to be provided to the customer are the office maintenance services for which the customer contracted, and that no other goods or services are promised to the customer. While the entity obtains a right to office maintenance services from the service provider after entering into the contract with the customer, that right is not transferred to the customer. That is, the entity retains the ability to direct the use of, and obtain substantially all the remaining benefits from, that right. For example, the entity can decide whether to direct the service provider to provide the office maintenance services for that customer, or for another customer, or at its own facilities. The customer does not have a right to direct the service provider to perform services that the entity has not agreed to provide. Therefore, the right to office maintenance services obtained by the entity from the service provider is not the specified good or service in its contract with the customer.

The entity concludes that it controls the specified services before they are provided to the customer. The entity obtains control of a right to office maintenance services after entering into the contract with the customer but before those services are provided to the customer. The terms of the entity's contract with the service provider give the entity the ability to direct the service provider to provide the specified services on the entity's behalf (see paragraph B35A(b)). In addition, the entity concludes that the following indicators in paragraph B37 of IFRS 15 provide further evidence that the entity controls the office maintenance services before they are provided to the customer:

(a) the entity is primarily responsible for fulfilling the promise to provide office maintenance services. Although the entity has hired a service provider to perform the services promised to the customer, it is the entity itself that is responsible for ensuring that the services are performed and are acceptable to the customer (ie the entity is responsible for fulfilment of the promise in the contract, regardless of whether the entity performs the services itself or engages a third-party service provider to perform the services).

(b) the entity has discretion in setting the price for the services to the customer.

The entity observes that it does not commit itself to obtain the services from the service provider before obtaining the contract with the customer. Thus, the entity has mitigated inventory risk with respect to the office maintenance services. Nonetheless, the entity concludes that it controls the office maintenance services before they are provided to the customer on the basis of the evidence in paragraph IE238E.

Thus, the entity is a principal in the transaction and recognises revenue in the amount of consideration to which it is entitled from the customer in exchange for the office maintenance services.

The standard also includes the following example of when the specified good or service is the right to obtain a service and not the underlying service itself. The entity in this example is determined to be a principal:

Extract from IFRS 15

Example 47 — Promise to provide goods or services (entity is a principal) (IFRS 15.IE239-IE243)

An entity negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. The entity agrees to buy a specific number of tickets and must pay for those tickets regardless of whether it is able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance.

The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are purchased.

The entity also assists the customers in resolving complaints with the service provided by the airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

To determine whether the entity's performance obligation is to provide the specified goods or services itself (ie the entity is a principal) or to arrange for those goods or services to be provided by another party (ie the entity is an agent), the entity identifies the specified good or service to be provided to the customer and assesses whether it controls that good or service before the good or service is transferred to the customer. The entity concludes that, with each ticket that it commits itself to purchase from the airline, it obtains control of a right to fly on a specified flight (in the form of a ticket) that the entity then transfers to one of its customers (see paragraph B35A(a)). Consequently, the entity determines that the specified good or service to be provided to its customer is that right (to a seat on a specific flight) that the entity controls. The entity observes that no other goods or services are promised to the customer.

The entity controls the right to each flight before it transfers that specified right to one of its customers because the entity has the ability to direct the use of that right by deciding whether to use the ticket to fulfil a contract with a customer and, if so, which contract it will fulfil. The entity also has the ability to obtain the remaining benefits from that right by either reselling the ticket and obtaining all of the proceeds from the sale or, alternatively, using the ticket itself.

The indicators in paragraphs B37(b)–(c) of IFRS 15 also provide relevant evidence that the entity controls each specified right (ticket) before it is transferred to the customer. The entity has inventory risk with respect to the ticket because the entity committed itself to obtain the ticket from the airline before obtaining a contract with a customer to purchase the ticket. This is because the entity is obliged to pay the airline for that right regardless of whether it is able to obtain a customer to resell the ticket to or whether it can obtain a favourable price for the ticket. The entity also establishes the price that the customer will pay for the specified ticket.

Thus, the entity concludes that it is a principal in the transactions with customers. The entity recognises revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred to the customers.

In the following example, the entity also determines that the specified good or service is the right to obtain a service and not the underlying service itself. However, the entity in this example is determined to be an agent.

Extract from IFRS 15

Example 48 — Arranging for the provision of goods or services (entity is an agent) (IFRS 15.IE244-IE248)

An entity sells vouchers that entitle customers to future meals at specified restaurants. The sales price of the voucher provides the customer with a significant discount when compared with the normal selling prices of the meals (for example, a customer pays CU100 for a voucher that entitles the customer to a meal at a restaurant that would otherwise cost CU200). The entity does not purchase or commit itself to purchase vouchers in advance of the sale of a voucher to a customer; instead, it purchases vouchers only as they are requested by the customers. The entity sells the vouchers through its website and the vouchers are non-refundable.

The entity and the restaurants jointly determine the prices at which the vouchers will be sold to customers. Under the terms of its contracts with the restaurants, the entity is entitled to 30 per cent of the voucher price when it sells the voucher.

The entity also assists the customers in resolving complaints about the meals and has a buyer satisfaction programme. However, the restaurant is responsible for fulfilling obligations associated with the voucher, including remedies to a customer for dissatisfaction with the service.

To determine whether the entity is a principal or an agent, the entity identifies the specified good or service to be provided to the customer and assess whether it controls the specified good or service before that good or service is transferred to the customer.

A customer obtains a voucher for the restaurant that it selects. The entity does not engage the restaurants to provide meals to customers on the entity's behalf as described in the indicator in paragraph B37(a) of IFRS 15. Therefore, the entity observes that the specified good or service to be provided to the customer is the right to a meal (in the form of a voucher) at a specified restaurant or restaurants, which the customer purchases and then can use itself or transfer to another person. The entity also observes that no other goods or services (other than the vouchers) are promised to the customers.

The entity concludes that it does not control the voucher (right to a meal) at any time. In reaching this conclusion, the entity principally considers the following:

(a) the vouchers are created only at the time that they are transferred to the customers and, thus, do not exist before that transfer. Therefore, the entity does not at any time have the ability to direct the use of the vouchers, or obtain substantially all of the remaining benefits from the vouchers, before they are transferred to customers.

(b) the entity neither purchases, nor commits itself to purchase, vouchers before they are sold to customers. The entity also has no responsibility to accept any returned vouchers. Therefore, the entity does not have inventory risk with respect to the vouchers as described in the indicator in paragraph B37(b) of IFRS 15.

Extract from IFRS 15 (cont'd)

Thus, the entity concludes that it is an agent with respect to the vouchers. The entity recognises revenue in the net amount of consideration to which the entity will be entitled in exchange for arranging for the restaurants to provide vouchers to customers for the restaurants' meals, which is the 30 per cent commission it is entitled to upon the sale of each voucher.

Frequently asked questions

Question 4-12: How would an entity determine whether it is a principal or an agent in a transaction for a specified good for which it only takes title momentarily or never has physical possession?

An entity's determination of whether it is a principal or an agent in this type of transaction requires significant judgement and careful consideration of the facts and circumstances. Entities may enter into contracts with third-party vendors (the vendors) to provide goods or services to be sold through their sales channels to their customers. In these arrangements, the entity may take legal title to the good only momentarily before the good is transferred to the customer, such as in scan-based trading or 'flash title' contracts (e.g., vendor is responsible for stocking, rotating and otherwise managing the product until the final point of sale). Alternatively, the entity may never take physical possession or legal title to the good (e.g., 'drop shipment arrangements' when goods are shipped directly from a vendor to the customer). In these situations, the entity needs to carefully evaluate whether it obtains control of the specified good and, therefore, is the principal in the transaction with the end-consumer. When evaluating the control principle and the principal indicators provided in the standard, we believe some questions an entity may consider when making this judgement could include:

- Does the entity take title to the goods at any point in the order-to-delivery process? If not, why?
- Is the vendor the party that the customer will hold responsible for the acceptability of the product (e.g., handling of complaints and returns)? If so, why?
- Does the entity have a return-to-vendor agreement with the vendor or have a history of returning goods to the vendor after a customer returns the good(s)? If so, why?
- Does the vendor have discretion in establishing the price for the goods (e.g., setting the floor or ceiling)? If so, why?
- Is the vendor responsible for the risk of loss or damage (e.g., shrinkage) while the goods are in the entity's store? If so, why?
- Does the vendor have the contractual right to take back the goods delivered to the entity and, if so, has the vendor exercised that right in situations other than when the goods were at the end of their useful lives?
- Can the entity move goods between their stores or relocate goods within their stores without first obtaining permission from the vendor? If not, why?

Frequently asked questions (cont'd)

- Does the entity have any further obligation to the customer after remitting the customer's order to the vendor? If not, why?
- Once a customer order is placed, can the entity direct the product to another entity or prevent the product from being transferred to the customer? If not, why?

An SEC staff member said in a speech that the application of the principal-versus-agent application guidance can be especially challenging when an entity never obtains physical possession of a good. While noting that the staff has seen these types of fact patterns with conclusions of both principal and agent, the staff member further discussed certain facts and circumstances of a registrant consultation with OCA in which the SEC staff did not object to a principal determination in a transaction in which certain specialised goods were shipped directly to the end-customer by the vendor (not the registrant). In reaching this conclusion, the SEC staff member reiterated that the determination requires consideration of the definition of control in the standard, which often includes consideration of the indicators in IFRS 15.B37. However, inventory risk is only one of those indicators and it is possible that physical possession will not coincide with control of a specified good.[160]

Understanding the business purpose and rationale for the contractual terms between the vendor and the entity may help the entity assess whether it controls the specified goods prior to the transfer to the end-consumer and is, therefore, the principal in the sale to the end-consumer.

Question 4-13: How would entities determine the presentation of amounts billed to customers (e.g., shipping and handling, expenses or cost reimbursements and taxes) under the standards (i.e., as revenue or as a reduction of costs)? [TRG meeting 18 July 2014 – Agenda paper no. 2]

TRG members generally agreed that the standard is clear that any amounts not collected on behalf of third parties would be included in the transaction price (i.e., revenue). As discussed in section 5, IFRS 15.47 says that "the transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes)". Therefore, if the amounts were earned by the entity in fulfilling its performance obligations, the amounts are included in the transaction price and recorded as revenue.

[160] Remarks by Sheri L. York, Professional Accounting Fellow, SEC Office of the Chief Accountant, 10 December 2018, SEC.gov.

Frequently asked questions (cont'd)

Shipping and handling

The appropriate presentation of amounts billed to customers for shipping and handling activities would depend on whether they entity is a principal or an agent in the shipping arrangement (see Question 10-8 in section 10.3 for further discussion on presentation of shipping and handling costs incurred by the entity).

Expense or cost reimbursements

Many service providers routinely incur incidental expenses, commonly referred to as 'out-of-pocket' expenses, in the course of conducting their normal operations. Those expenses often include, but are not limited to, airfare, other travel-related costs (such as car rentals and hotel accommodation) and telecommunications charges. The entity (i.e., the service provider) and the customer may agree that the customer will reimburse the entity for the actual amount of such expenses incurred. Alternatively, the parties may negotiate a single fixed fee that is intended to compensate the service provider for both professional services rendered and out-of-pocket expenses incurred.

Out-of-pocket expenses are often costs incurred by an entity in fulfilling its performance obligation(s) (i.e., the out-of-pocket expenses are fulfilment costs) and do not transfer a good or service to the customer. In these situations, reimbursement for such costs generally should be included in the entity's estimate of the transaction price and recognised as revenue when (or as) the performance obligation(s) is (are) satisfied, even if the entity is reimbursed at 'cost' (i.e., at zero margin). Alternatively, if an entity concludes that the costs *do* transfer a good or service to the customer, it should consider the principal-versus-agent application guidance when determining whether reimbursement amounts received from its customer need to be recorded on a gross or net basis.

In some cases, it may be appropriate to include the reimbursement in the transaction price and recognise that amount as revenue when the applicable expense is incurred. That is, an entity may not have to estimate out-of-pocket expenses in its determination of the transaction price at contract inception. This was discussed in a US Private Company Council meeting under US GAAP. The FASB staff observed in the related staff paper the following situations in which this would be the case:[161]

- The entity is an agent as it relates to the specified good or service identified (see section 4.4). That is, in cases in which the entity is an agent and the reimbursement is equal to the cost, the net effect on revenue would be zero and, therefore, no estimation would be required.

[161] FASB staff Private Company Council Memo, *Reimbursement of Out-of-Pocket Expenses*, dated 26 June 2018. Refer to the FASB's website.

Frequently asked questions (cont'd)

- The variable consideration is constrained (see section 5.2.3). That is, if a portion of the transaction price related to reimbursements of out-of-pocket expenses is constrained, an entity would not include an estimate in the transaction price for that amount until it becomes highly probable that a significant revenue reversal will not occur, which may be when the underlying out-of-pocket expenses are incurred in some cases. For example, an entity may not be able to make reliable estimates of expenses and the related reimbursements that will not be subject to a significant revenue reversal due to a lack of historical evidence.
- The variable consideration relates specifically to a performance obligation or a distinct good or service in a series and the entity meets the variable consideration exception (see section 6.3).
- The entity qualifies to apply the 'right to invoice' practical expedient (see section 7.1.4.A).
- The entity applies a 'costs incurred' measure of progress when recognising revenue for over-time performance obligations (see section 7.1.4). That is, if an entity selects a 'costs incurred' method, the timing of the costs being incurred and the revenue recognition associated with those costs would align.

Taxes or other assessments

Several TRG members noted that this would require entities to evaluate taxes collected in all jurisdictions in which they operate to determine whether a tax is levied on the entity or the customer. TRG members generally agreed that an entity would apply the principal versus agent application guidance when it is not clear whether the amounts are collected on behalf of third parties. This could result in amounts billed to a customer being recorded as an offset to costs incurred (i.e., on a net basis).

Question 4-14: How should an entity allocate the transaction price in a contract with multiple performance obligations in which the entity acts as both a principal and an agent?

See response to Question 6-7 in section 6.2.

FASB differences

The FASB's standard allows an entity to make an accounting policy choice to present revenue net of certain types of taxes collected from a customer (including sales, use, value-added and some excise taxes). The FASB included this policy choice to address a concern expressed by stakeholders in the US as to the operability of the requirements under US GAAP. IFRS 15 does not provide a similar accounting policy choice for the following reasons: it would reduce comparability; the requirements in IFRS 15 are consistent with those in legacy IFRS;[162] and it would create an exception to the five-step model.[163] Since entities do not have a similar accounting policy choice under IFRS, differences could arise between IFRS and US GAAP.

Another difference relates to determining the transaction price when an entity is the principal, but is unable to determine the ultimate price charged to the customer. In the Basis for Conclusions on its May 2016 amendments, the FASB stated that, if uncertainty related to the transaction price is not ultimately expected to be resolved, it would not meet the definition of variable consideration and, therefore, should not be included in the transaction price.[164] Stakeholders had raised a question about how an entity that is a principal would estimate the amount of revenue to recognise if it were not aware of the amounts being charged to end-customers by an intermediary that is an agent. The IASB did not specifically consider how the transaction price requirements would be applied in these situations (i.e., when an entity that is a principal does not know and expects not to know the price charged to its customer by an agent), but concluded in the Basis for Conclusions that an entity that is a principal would generally be able to apply judgement and determine the consideration to which it is entitled using all information available to it.[165] Accordingly, we believe that it is possible that IFRS and US GAAP entities will reach different conclusions on estimating the gross transaction price in these situations.

4.5 Consignment arrangements

The standard provides specific application guidance for a promise to deliver goods on a consignment basis to other parties. See section 7.4.

[162] IAS 18.8.
[163] IFRS 15.BC188D.
[164] FASB ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations* (March 2016), paragraph BC38.
[165] IFRS 15.BC385Z.

4.6 Customer options for additional goods or services (updated October 2020)

Many sales contracts give customers the option to acquire additional goods or services. These additional goods or services may be priced at a discount or may even be free of charge. Options to acquire additional goods or services at a discount can come in many forms, including sales incentives, volume-tiered pricing structures, customer award credits (e.g., frequent flyer points) or contract renewal options (e.g., waiver of certain fees, reduced future rates). See the Questions that follow this section, which discuss many of these different types of customer options.

When an entity grants a customer the option to acquire additional goods or services, that option is only a separate performance obligation if it provides a material right to the customer that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). Refer to Question 4-19 below for further discussion on the evaluation of class of customer. If the option provides a material right to the customer, the customer has, in effect, paid in advance for future goods or services. As such, the entity recognises revenue when those future goods or services are transferred or when the option expires. In the Basis for Conclusions, the IASB indicated that the purpose of this requirement is to identify and account for options that customers are paying for (often implicitly) as part of the current transaction.[166]

The Board did not provide any bright lines as to what constitutes a 'material' right. However, the standard requires that an option to purchase additional goods or services at their stand-alone selling prices does not provide a material right and, instead, is a marketing offer. This is the case even if the customer has obtained the option only as a result of entering into a previous contract. However, an option to purchase additional goods or services in the future at the current stand-alone selling price could be a material right if prices are highly likely to significantly increase. This could also be the case if a renewal option at the current stand-alone selling price is offered for an extended period of time and the stand-alone selling price for the product is highly likely to significantly increase, depending on the facts and circumstances of the contract. This is because the customer is being offered a discount on future goods or services compared to what others will have to pay in the future as a result of entering into the previous contract. The standard states that this is the case even if the option can only be exercised because the customer entered into the earlier transaction. An entity that has made a marketing offer accounts for it in accordance with IFRS 15 only when the customer exercises the option to purchase the additional goods or services.[167]

How we see it

Significant judgement may be required to determine whether a customer option represents a material right. This determination is important because it affects the accounting and disclosures for the contract at inception and throughout the life of the contract.

[166] IFRS 15.BC386.
[167] IFRS 15.B41.

The standard includes the following example to illustrate the determination of whether an option represents a material right (see section 6.1.5 for a discussion of the measurement of options that are separate performance obligations):

Extract from IFRS 15

Example 49 — Option that provides the customer with a material right (discount voucher) (IFRS 15.IE250-IE253)

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 up to CU100 in the next 30 days. The entity intends to offer a 10 per cent discount on all sales during the next 30 days as part of a seasonal promotion. The 10 per cent discount cannot be used in addition to the 40 per cent discount voucher.

Because all customers will receive a 10 per cent discount on purchases during the next 30 days, the only discount that provides the customer with a material right is the discount that is incremental to that 10 per cent (ie the additional 30 per cent discount). The entity accounts for the promise to provide the incremental discount as a performance obligation in the contract for the sale of Product A.

To estimate the stand-alone selling price of the discount voucher in accordance with paragraph B42 of IFRS 15, 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. Consequently, the entity's estimated stand-alone selling price of the discount voucher is CU12 (CU50 average purchase price of additional products × 30 per cent incremental discount × 80 per cent likelihood of exercising the option).

The stand-alone selling prices of Product A and the discount voucher and the resulting allocation of the CU100 transaction price are as follows:

Performance obligations	Stand-alone selling price	
	CU	
Product A	100	
Discount voucher	12	
Total	112	

	Allocated transaction price	
Product A	89	(CU100 ÷ CU112 × CU100)
Discount voucher	11	(CU12 ÷ CU112 × CU100)
Total	100	

The entity allocates CU89 to Product A and recognises revenue for Product A when control transfers. The entity allocates CU11 to the discount voucher and recognises revenue for the voucher when the customer redeems it for goods or services or when it expires.

Evaluating whether an option provides a material right may be more complex when the stand-alone selling price of the good or service is highly variable, as illustrated below:

Illustration 4-10 — Evaluating a customer option when the stand-alone selling price is highly variable

Technology entity Y enters into a contract with Customer Z for a perpetual licence of software A, with one year of post-contract support (PCS). The contract also includes an option to purchase additional licences of software A at 40% off the list price.

The entity does not sell software A separately, but it sells PCS separately in the form of renewals that are consistently priced at 20% of the net licence fee. Assume that Technology entity Y uses the residual method to estimate the stand-alone selling price of the perpetual licence for software A (see section 6.1.2). Also assume that the price Technology entity Y charges for the bundle of the perpetual licence and PCS is highly variable. That is because the price Technology entity Y charges to customers in the same class and same market as Customer Z who have not made prior purchases ranges from the list price to a discounted price of up to 70% off the list price for the bundle. Assume that the entity has appropriately stratified its contracts/customers to evaluate the range of discounts and has a sufficient amount of transactions to support that this is the range of discounts it offers.

Since the 40% discount Technology entity Y offered to Customer Z is within the range of discounts it typically offers to customers in the same class as Customer Z, Technology entity Y concludes that this option does not represent a material right.

While the customer option is determined not to be a material right in this example, that might not always be the case. An entity would need to evaluate all customer options, even those for which the price of the good or service that is subject to the option is highly variable and for which the residual approach was used.

Frequently asked questions

Question 4-15: Would entities consider only the current transaction or would they consider past and future transactions with the same customer when determining whether an option for additional goods or services provides the customer with a material right? [TRG meeting 31 October 2014 – Agenda paper no. 6]

TRG members generally agreed that entities should consider all relevant transactions with a customer (i.e., current, past and future transactions), including those that provide accumulating incentives, such as loyalty programmes, when determining whether an option represents a material right. That is, the evaluation is not solely performed in relation to the current transaction.

Frequently asked questions (cont'd)

Question 4-16: Is the material right evaluation solely a quantitative evaluation or does the evaluation also consider qualitative factors? [TRG meeting 31 October 2014 – Agenda paper no. 6]

TRG members generally agreed that the evaluation should consider both quantitative and qualitative factors that would be known to the entity (e.g., what a new customer would pay for the same service, the availability and pricing of competitors' service alternatives, whether the average customer life indicates that the fee provides an incentive for customers to remain beyond the stated contract term, whether the right accumulates). This is because a customer's perspective on what constitutes a 'material right' may consider qualitative factors. This is consistent with the notion that when identifying promised goods or services in Step 2, an entity considers reasonable expectations of the customer that the entity will transfer a good or service to it.

Question 4-17: How would an entity distinguish between a contract that contains an option to purchase additional goods or services and a contract that includes variable consideration (see section 5.2) based on a variable quantity (e.g., a usage-based fee)? [TRG meeting 9 November 2015 – Agenda paper no. 48]

Entities have found it challenging to distinguish between a contract that includes customer options to purchase additional goods or services and one that includes variable consideration based on a variable quantity (e.g., a usage-based fee). This is because, under both types of contracts, the ultimate quantity of goods or services to be transferred to the customer is often unknown at contact inception. TRG members generally agreed that this determination requires judgement and consideration of the facts and circumstances. They also generally agreed that the TRG agenda paper on this question provides a framework that helps entities to make this determination.

This determination is important because it affects the accounting for the contract at inception and throughout the life of the contract, as well as disclosures. If an entity concludes that a customer option for additional goods or services provides a material right, the option itself is deemed to be a performance obligation in the contract, but the underlying goods or services are not accounted for until the option is exercised (as discussed below in Question 4-18). As a result, the entity is required to allocate a portion of the transaction price to the material right at contract inception and to recognise that revenue when or as the option is exercised or the option expires. If an entity, instead, concludes that an option for additional goods or services is not a material right, there is no accounting for the option and no accounting for the underlying optional goods or services until those subsequent purchases occur.

However, if the contract includes variable consideration (rather than a customer option), an entity has to estimate at contract inception the variable consideration expected over the life of the contract and update that estimate each reporting period (subject to the constraint on variable consideration) (see section 5.2). There are also more disclosures required for variable consideration (e.g., the requirement to disclose the remaining transaction price for unsatisfied performance obligations) (see section 10.5.1) than for options that are not determined to be material rights.

The TRG agenda paper explained that the first step (in determining whether a contract involving variable quantities of goods or services should be

Frequently asked questions (cont'd)

accounted for as a contract containing customer options or variable consideration) is for the entity to determine the nature of its promise in providing goods or services to the customer and the rights and obligations of each party.

In a contract in which the variable quantity of goods or services results in variable consideration, the nature of the entity's promise is to transfer to the customer an overall service. In providing this overall service, an entity may perform individual tasks or activities. At contract inception, the entity is presently obliged by the terms and conditions of the contract to transfer all promised goods or services provided under the contract and the customer is obliged to pay for those promised goods or services. This is because the customer entered into a contract that obliges the entity to transfer those goods or services. The customer's subsequent actions to utilise the service affect the measurement of revenue (in the form of variable consideration), but do not oblige the entity to provide additional distinct goods or services beyond those promised in the contract.

For example, consider a contract between a transaction processor and a customer in which the processor will process all of the customer's transactions in exchange for a fee paid for each transaction processed. The ultimate quantity of transactions that will be processed is not known. The nature of the entity's promise is to provide the customer with continuous access to the processing platform so that submitted transactions are processed. By entering into the contract, the customer has made a purchasing decision that obliges the entity to provide continuous access to the transaction processing platform. The consideration paid by the customer results from events (i.e., additional transactions being submitted for processing to the processor) that occur after (or as) the entity transfers the payment processing service. The customer's actions do not oblige the processor to provide additional distinct goods or services because the processor is already obliged (starting at contract inception) to process all transactions submitted to it.

Another example described in the TRG agenda paper of contracts that may include variable consideration was related to certain IT outsourcing contracts. Under this type of contract (similar to the transaction processing contract, discussed above), the entity provides continuous delivery of a service over the contract term and the amount of service provided is variable.

Example of variable consideration

An entity enters into a 10-year IT outsourcing arrangement with a customer in which it provides continuous delivery of outsourced activities over the contract term. The entity provides server capacity, manages the customer's software portfolio and runs an IT help desk. The total monthly invoice is calculated based on the units consumed for each activity. For example, the billings might be based on millions of instructions per second of computing power, the number of software applications used or the number of employees supported. The price per unit differs for each type of activity.

Frequently asked questions (cont'd)

Example of variable consideration (cont'd)

At contract inception, it is unknown how many outsourced activities the entity will perform for the customer throughout the life of the contract. The question that arises is whether the customer makes optional purchases when it sends activities to the entity to be performed or whether its use of the service affects the measurement of revenue (in the form of variable consideration).

The conclusion in the TRG agenda paper was that it is likely that this contract contains variable consideration because of the nature of the entity's promise. The customer is paying for the entity to stand ready to perform in an outsourcing capacity on any given day. The customer does not make a separate purchasing decision each time it sends a unit for processing. Instead, the customer made its purchasing decision when it entered into the outsourcing contract with the entity. Therefore, the customer's actions to use the service also do not oblige the entity to provide any additional distinct goods or services.

In contrast, when an entity provides a customer option, the nature of its promise is to provide the quantity of goods or services specified in the contract, if any, and a right for the customer to choose the amount of additional distinct goods or services the customer will purchase. That is, the entity is not obliged to provide any additional distinct goods or services until the customer exercises the option. The customer has a contractual right that allows it to choose the amount of additional distinct goods or services to purchase, but the customer has to make a separate purchasing decision to obtain those additional distinct goods or services. Prior to the customer's exercise of that right, the entity is not obliged to provide (nor does it have a right to consideration for transferring) those goods or services.

Since an option that is a marketing offer is considered a new contract if it is exercised, the IASB staff noted in the TRG agenda paper that an analogy to the contract modification requirements in IFRS 15.20-21 (see section 3.4) could be helpful when an entity is distinguishing between optional purchases and variable consideration. For a modification to be considered a separate contract, one of the criteria is that the modification results in the addition of promised goods or services that are distinct. Similarly, the IASB staff noted that the exercise of a customer option would typically result in the addition of promised goods or services that are distinct.

The TRG agenda paper included the following example of a contract that includes a customer option (rather than variable consideration):

Example of customer option that is not a material right

Entity B enters into a contract to provide 100 widgets to Customer Y in return for consideration of CU10 per widget. Each widget is a distinct good transferred at a point in time. The contract also gives Customer Y the right to purchase additional widgets at the stand-alone selling price of CU10 per widget. Therefore, the quantity that may be purchased by Customer Y is variable.

The conclusion in the TRG agenda paper was that, while the quantity of widgets that may be purchased is variable, the transaction price for the existing contract is fixed at CU1,000 [100 widgets x CU10 per widget].

Frequently asked questions (cont'd)

Example of customer option that is not a material right (cont'd)

That is, the transaction price only includes the consideration for the 100 widgets specified in the contract and the customer's decision to purchase additional widgets is an option. While Entity B may be required to deliver additional widgets in the future, Entity B is not legally obligated to provide the additional widgets until Customer Y exercises the option. In this example, the option is accounted for as a separate contract because there is no material right, since the pricing of the option is at the stand-alone selling price of the widgets.

Contrast the above example with another contract that includes a customer option that is determined to be a material right:

Illustration 4-11: Customer option that is a material right

Entity B enters into a contract to provide 100 widgets to Customer Y at CU10 per widget (which is the widget's stand-alone selling price at contract inception). Each widget is a distinct good transferred at a point in time. The contract also gives Customer Y the right to purchase additional widgets at CU9 per widget. Therefore, the quantity that may be purchased by Customer Y is variable.

While the quantity of widgets that may be purchased is variable, the transaction price for the existing contract is fixed at CU1,000 [100 widgets x CU10 per widget]. That is, the transaction price only includes the consideration for the 100 widgets specified in the contract, and the customer's decision to purchase additional widgets is an option. While Entity B may be required to deliver additional widgets in the future, Entity B is not legally obligated to provide the additional widgets until Customer Y exercises the option.

Entity B determines that Customer Y obtained a discount on future widgets because CU9 per widget is lower than the stand-alone selling price of each widget at contract inception (i.e., CU10 per widget), as well as being lower than the expected stand-alone selling price at renewal. In this example, the option is accounted for as a material right.

Frequently asked questions (cont'd)

The TRG agenda paper also included the following example of a contract in which the variable quantity of goods or services includes a customer option:

Example of customer option

A supplier enters into a five-year master supply arrangement in which the supplier is obliged to produce and sell parts to a customer at the customer's request. That is, the supplier is not obliged to transfer any parts until the customer submits a purchase order. In addition, the customer is not obliged to purchase any parts; however, it is highly likely it will do so because the part is required to manufacture the customer's product and it is not practical to obtain parts from multiple suppliers. Each part is determined to be a distinct good that transfers to the customer at a point in time.

The conclusion in the TRG agenda paper was that the nature of the promise in this example is the delivery of parts (and not a service of standing ready to produce and sell parts). That is, the contract provides the customer with a right to choose the quantity of additional distinct goods (i.e., it provides a customer option), rather than a right to use the services for which control to the customer has (or is currently being) transferred (such as in the transaction processor example above). Similarly, the supplier is not obliged to transfer any parts until the customer submits the purchase order (another important factor in distinguishing a customer option from variable consideration). In contrast, in certain other fact patterns, the supplier is obliged to make the promised services available to the customer without any additional decisions made by the customer.

The TRG agenda paper contrasted this example with other contracts that may include a stand-ready obligation (e.g., a customer's use of a health club). When the customer submits a purchase order under the master supply arrangement, it is contracting for a specific number of distinct goods, which creates new performance obligations for the supplier. In contrast, a customer using services in a health club is using services that the health club is already obliged to provide under the present contract. That is, there are no new obligations arising from the customer's usage.

Frequently asked questions (cont'd)

The TRG agenda paper also included the following example of a contract in which the variable quantity of goods or services results in variable consideration:

Example of variable consideration

Entity A enters into a contract to provide equipment to Customer X. The equipment is a single performance obligation transferred at a point in time. Entity A charges Customer X based on its usage of the equipment at a fixed rate per unit of consumption. The contract has no minimum payment guarantees. Customer X is not contractually obliged to use the equipment. However, Entity A is contractually obliged to transfer the equipment to Customer X.

The conclusion in the TRG agenda paper was that the usage of the equipment by Customer X is a variable quantity that affects the amount of consideration owed to Entity A. It does not affect Entity A's performance obligation, which is to transfer the piece of equipment. That is, Entity A has performed by transferring the distinct good. Customer X's actions, which result in payment to Entity A, occur after the equipment has been transferred and do not require Entity A to provide additional goods or services.

Question 4-18: When, if ever, would an entity consider the goods or services underlying a customer option as a separate performance obligation? [TRG meeting 9 November 2015 – Agenda paper no. 48]

TRG members generally agreed that an entity does not need to identify the additional goods or services underlying the option as promised goods or services (or performance obligations) if there are no contractual penalties (e.g., termination fees, monetary penalties for not meeting contractual minimums), even if it believes that it is virtually certain that a customer will exercise its option for additional goods or services. Only the option is assessed to determine whether it represents a material right (and accounted for as a performance obligation). As a result, any consideration that would be received in return for optional goods or services is not included in the transaction price at contract inception. The TRG agenda paper included the following example of a contract in which it is virtually certain that a customer will exercise its option for additional goods or services:

Example of customer option with no contractual penalties

An entity sells equipment and consumables, both of which are determined to be distinct goods that are recognised at a point in time. The stand-alone selling price of the equipment and each consumable is CU10,000 and CU100, respectively. The equipment costs CU8,000 and each consumable costs CU60. The entity sells the equipment for CU6,000 (i.e., at a 40% discount on its stand-alone selling price) with a customer option to purchase each consumable for CU100 (i.e., equal to its stand-alone selling price). There are no contractual minimums, but the entity estimates the customer will purchase 200 parts over the next two years. This is an exclusive contract in which the customer cannot purchase the consumables from any other vendors during the contract term.

Frequently asked questions (cont'd)

Example of customer option with no contractual penalties (cont'd)

TRG members generally agreed that the consumables underlying each option would not be considered part of the contract. Furthermore, the option does not represent a material right because it is priced at the stand-alone selling price for the consumable. This is the case even though the customer is compelled to exercise its option for the consumables because the equipment cannot function without the consumables and the contract includes an exclusivity clause that requires the customer to acquire the consumables only from the entity. Accordingly, the transaction price is CU6,000 and it is entirely attributable to the equipment. This would result in a loss for the entity of CU2,000 when it transfers control of the equipment to the customer.

However, contractual minimums may represent fixed consideration in a contract, even if the contract also contains optional purchases. For example, an MSA may set minimum purchase quantities that the entity is obliged to provide, but any quantities above the minimum may require the customer to make a separate purchasing decision (i.e., exercise a customer option). If contractual penalties exist (e.g., termination fees, monetary penalties assessed) for not meeting contractual minimums, it may be appropriate to include some or all of the goods or services underlying customer options as part of the contract at inception. This is because the penalty effectively creates a minimum purchase obligation for the goods or services that would be purchased if the penalty were enforced.

Example of customer option with contractual penalties

Consider the same facts as in the example above, except that the customer will incur a penalty if it does not purchase at least 200 consumables. That is, the customer will be required to repay some or all of the CU4,000 discount provided on the equipment. Per the contract terms, the penalty decreases as each consumable is purchased at a rate of CU20 per consumable.

The conclusion in the TRG agenda paper was that the penalty is substantive and it effectively creates a minimum purchase obligation. As a result, the entity concludes that the minimum number of consumables required to avoid the penalty would be evidence of enforceable rights and obligations. The entity would then calculate the transaction price as CU26,000 [(200 consumables x CU100/consumable) + CU6,000 (the selling price of the equipment)]. Furthermore, the conclusion in the TRG agenda paper was that, if the customer failed to purchase 200 consumables, the entity accounts for the resulting penalty as a contract modification.

Frequently asked questions (cont'd)

Question 4-19: How should an entity consider the class of customer when evaluating whether a customer option is a material right? [18 April 2016 FASB TRG meeting; agenda paper no. 54]

FASB TRG members generally agreed that an entity should consider 'class of customer' when determining whether a customer option to acquire additional goods or services represents a material right. In addition, in making this evaluation, they agreed that an entity first determines whether the customer option exists independently of the existing contract. That is, would the entity offer the same pricing to a similar customer independent of a prior contract with the entity? If the pricing is independent, the option is considered a marketing offer and there is no material right. FASB TRG members also generally agreed that it is likely that the determination will require an entity to exercise significant judgement and consider all facts and circumstances.

As discussed above, IFRS 15.B40 states that when an entity grants a customer the option to acquire additional goods or services, that option is a separate performance obligation if it provides a material right that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that region or market). Furthermore, IFRS 15.B41 states that an option to purchase additional goods or services at their stand-alone selling prices does not provide a material right and instead is a marketing offer. The FASB staff noted in the TRG agenda paper that these requirements are intended to make clear that a customer option to acquire additional goods or services would not give rise to a material right if a customer could execute a separate contract to obtain the goods or services at the same price. That is, customer options that would exist independently of an existing contract with a customer do not constitute performance obligations in that existing contract.

The TRG agenda paper provided several examples of the FASB staff's views on this topic, including the following:

Example of class of customer evaluation

Retailer owns and operates several electronic stores and currently provides customers who purchase a 50-inch television with a coupon for 50% off the purchase of a stereo system. The coupon must be redeemed at one of Retailer's stores and is valid for one year. Retailer has never offered a discount of this magnitude to a customer that does not purchase a television (or another item of similar value).

Customer A purchases a 50-inch television from Retailer. At the time of purchase, Customer A receives a coupon for 50% off a stereo system. In evaluating whether the 50% discount provided to Customer A exists independently of its existing contract to purchase a television, Retailer needs to compare the discount offered to Customer A (50%) with the discount typically offered to other customers independent of a prior contract (purchase) with Retailer. For customers that do not purchase a 50-inch television, the only promotion Retailer is running on the stereo system is offering a 5% off coupon to all customers walking into the store. It would not be appropriate for Retailer to compare the discount offered to

Frequently asked questions (cont'd)

Example of class of customer evaluation (cont'd)

Customer A with a discount offered to another customer that also purchased a 50-inch television. This is because the objective of the requirements in IFRS 15.B40-B41 is to determine whether a customer option exists independently of an existing contract with a customer.

Retailer determines that the discount offered to Customer A is not comparable to the discount typically offered to customers without a prior contract (purchase). Rather, Customer A is receiving an incremental discount that it would not have received had it not entered into a contract to purchase a 50-inch television. The incremental discount provided to Customer A represents a material right.

Question 4-20: Should volume rebates and/or discounts on goods or services be accounted for as variable consideration or as customer options to acquire additional goods or services at a discount?

It depends on whether rebate or discount programme is applied retrospectively or prospectively.

Generally, if a volume rebate or discount is applied prospectively, we believe the rebate or discount would be accounted for as a customer option (not variable consideration). This is because the consideration for the goods or services in the present contract is not contingent upon or affected by any future purchases. Rather, the discounts available from the rebate programme affect the price of future purchases. Entities need to evaluate whether the volume rebate or discount provides the customer with an option to purchase goods or services in the future at a discount that represents a material right (and is, therefore, accounted for as a performance obligation) (see Question 4-21 below).

However, we believe a volume rebate or discount that is applied retrospectively is accounted for as variable consideration (see section 5.2). This is because the final price of each good or service sold depends upon the customer's total purchases that are subject to the rebate programme. That is, the consideration is contingent upon the occurrence or non-occurrence of future events. This view is consistent with Example 24 in the standard (which is extracted in full in section 5.2.1).

Entities should keep in mind that they need to evaluate whether contract terms, other than those specific to the rebate or discount programme, create variable consideration that needs to be separately evaluated (e.g., if the goods subject to the rebate programme are also sold with a right of return).

Frequently asked questions (cont'd)

Question 4-21: How should an entity consider whether prospective volume discounts determined to be customer options are material rights? [FASB TRG meeting 18 April 2016 - Agenda paper no. 54]

FASB TRG members generally agreed that in making this evaluation, similar to the discussion above in Question 4-20, an entity would first evaluate whether the option exists independently of the existing contract. That is, would the entity offer the same pricing to a similar high-volume customer independent of a prior contract with the entity? If yes, it indicates that the volume discount is not a material right, as it is not incremental to the discount typically offered to a similar high-volume customer. If the entity typically charges a higher price to a similar customer, it may indicate that the volume discount is a material right as the discount is incremental.

The TRG agenda paper included the following example:

Example of volume discounts

Entity enters into a long-term master supply arrangement with Customer A to provide an unspecified volume of non-customised parts. The price of the parts in subsequent years is dependent upon Customer A's purchases in the current year. That is, Entity charges Customer A CU1.00 per part in year one and if Customer A purchases more than 100,000 parts, the year two price will be CU0.90 per part.

When determining whether the contract between Entity and Customer A includes a material right, Entity first evaluates whether the option provided to Customer A exists independently of the existing contract. To do this, Entity compares the discount offered to Customer A with the discount typically offered to a similar high-volume customer that receives a discount independent of a prior contract with Entity. Such a similar customer could be Customer B who places a single order with Entity for 105,000 parts. Comparing the price offered to Customer A in year two with offers to other customers that also receive pricing that is contingent on prior purchases would not help Entity determine whether Customer A would have been offered the year two price had it not entered into the original contract.

Volume discounts or tiered pricing can make an entity's assessment of whether a customer option to purchase additional goods or services is a material right more complex. It is likely that this assessment will require significant judgement, as illustrated below:

Illustration 4-12: Evaluating a customer option with volume discounts

Semi-conductor Entity S sells microchips for use in cell phones. The entity executes a contract with a customer to sell one million units of microchip M for CU0.50 each (or CU500,000). The contract provides the right for the customer to purchase an additional 200,000 microchips for CU0.40 each.

The entity concludes that it has provided the customer with an option to purchase the additional microchips since the entity is not obligated to provide the additional goods until the customer makes a purchasing decision. Furthermore, the volume discount is applied prospectively and does not affect the transaction price in the original contract.

Frequently asked questions (cont'd)

Illustration 4-12: Evaluating a customer option with volume discounts (cont'd)

Scenario A

For microchip M, Semi-conductor Entity S provides volume discounts as part of its standard pricing practices and typically prices the first one million microchips at CU0.50 each, the second million at CU0.40 each and any additional amounts at CU0.35 each.

Semi-conductor Entity S considers whether the option provides the customer with a material right. To make this evaluation, the entity compares the discount offered in this option with the discount it typically offers to a similar high-volume customer that receives a discount without having had a prior contract. In other words, the entity compares the pricing in this contract to the pricing it typically offers to customers that purchase between one million and two million units of microchip M without having made any prior purchases.

The entity has sold, and continues to sell, the same volume of microchip M at the same price to other customers in the same class of customer who have not made prior purchases (i.e., similar customers pay CU0.50 each for the first one million microchips and CU0.40 each for the second million). That is, the price offered to the customer in the option exists independently of the existing contract. Therefore, Semi-conductor Entity S concludes that it has not provided the customer with a material right.

Scenario B

For microchip M, Semi-conductor Entity S provides volume discounts as part of its standard pricing practices and typically prices the first three million microchips at CU0.50 each and any additional amounts at CU0.30 each.

Semi-conductor Entity S considers whether the option provides the customer with a material right. To make this evaluation, the entity compares the discount offered in this option with the discount it typically offers to a similar high-volume customer that receives a discount without having had a prior contract.

For similar high-volume customers of the same customer class who have not made prior purchases, the entity typically does not provide this pricing (e.g., similar customers would pay CU0.50 per microchip for all 1.2 million microchips). Therefore, the entity concludes that it has provided the customer with a material right.

Question 4-22: How would an entity consider whether a renewal option is a material right?

An entity assesses whether a renewal option represents a material right in the same manner as other customer options discussed above. That is, an entity would determine whether the customer renewal option would be offered at the same price to a similar class of customer, independent of a prior contract with the entity. Customer renewal options may be explicitly included in the original contract or, as discussed in section 5.8, the existence of a non-refundable upfront fee may indicate that the contract includes a renewal option for future goods or services (e.g., if the customer renews the contract without the payment of an additional upfront fee).

Frequently asked questions (cont'd)

As discussed above in section 4.6, IFRS 15.B41 specifies that if a customer has the option to purchase additional goods or services (e.g., by exercising a renewal option) at a price that would reflect the stand-alone selling prices of those goods or services, the renewal option would not provide a material right and, instead, is a marketing offer. Determining the stand-alone selling price of a renewal option may require significant judgement. For example, a renewal option offered at the current stand-alone selling price may or may not be determined to be a material right. That is, if the pricing for the goods and service are expected to remain stable, it would be appropriate for a renewal option offered at a current stand-alone selling price to be considered a marketing offer. In contrast, a renewal option at the current stand-alone selling price could be a material right if, for example, prices are highly likely to significantly increase or the renewal option is offered for an extended period of time.

Example 51 from the standard describes the accounting for a renewal option that is a material right. That example also includes guidance on how to allocate a portion of the transaction price to the material right, which is further discussed in section 6.1.5.

Question 4-23: How would an entity consider whether a loyalty or reward programme is a material right?

Entities frequently offer loyalty or reward programmes under which customers accumulate points that they can redeem for 'free' or discounted products or services. Under IFRS 15.B40, an entity typically concludes that such a loyalty or reward programme provides a material right to customers that they would not receive without entering into a contract. This is because the customer effectively pays in advance for the right to obtain a future good or service (e.g., travel, upgrades, products) or a discount on that good or service.

This is also consistent with the discussion of the TRG members, as noted above in Questions 4-15 and 4-16, that entities should consider all relevant transactions with a customer (i.e., current, past and future transactions) and both quantitative and qualitative factors, including those that provide accumulating incentives, when determining whether an option represents a material right.Example 52 in the standard (extracted in section 7.9) illustrates the accounting for a loyalty programme.

Question 4-24: How would an entity account for the exercise of a material right? That is, would an entity account for it as: a contract modification, a continuation of the existing contract or variable consideration?
[TRG meeting 30 March 2015 – Agenda paper no. 32]

TRG members generally agreed that it is reasonable for an entity to account for the exercise of a material right as either a contract modification or as a continuation of the existing contract (i.e., a change in the transaction price). TRG members also generally agreed that it is not appropriate to account for the exercise of a material right as variable consideration.

Frequently asked questions (cont'd)

Under the approach that treats the exercise of a material right as a continuation of the existing contract (i.e., because the customer decided to purchase additional goods or services contemplated in the original contract), an entity would update the transaction price of the contract to include any consideration to which the entity expects to be entitled as a result of the exercise, in accordance with the requirements for changes in the transaction price included in IFRS 15.87-90 (see section 6.5).

Under these requirements, changes in the total transaction price are generally allocated to the separate performance obligations on the same basis as the initial allocation. However, IFRS 15.89 requires an entity to allocate a change in the transaction price entirely to one or more, but not all, performance obligations if the criteria of IFRS 15.85 are met. These criteria (discussed further in section 6.3) are that the additional consideration specifically relates to the entity's efforts to satisfy the performance obligation(s) and that allocating the additional consideration entirely to one or more, but not all, performance obligation(s) is consistent with the standard's allocation objective (see section 6). The additional consideration received for the exercise of the option is likely to meet the criteria to be allocated directly to the performance obligation(s) underlying the material right. Revenue would be recognised when (or as) the performance obligation(s) is (are) satisfied.

The TRG agenda paper included the following example:

Example of the exercise of a material right under the requirements for changes in the transaction price

Entity enters into a contract with Customer to provide two years of Service A for CU100 and includes an option for Customer to purchase two years of Service B for CU300. The stand-alone selling prices of Services A and B are CU100 and CU400, respectively. Entity concludes that the option represents a material right and its estimate of the stand-alone selling price of the option is CU33. Entity allocates the CU100 transaction price to each performance obligation as follows:

	Transaction Price	Stand-alone selling price	%	Allocation
Service A		CU100	75%	CU75
Option		CU33	25%	CU25
Totals	CU100	CU133	100%	CU100

Frequently asked questions (cont'd)

Example of the exercise of a material right under the requirements for changes in the transaction price (cont'd)

Upon executing the contract, Customer pays CU100 and Entity begins transferring Service A to Customer. The consideration of CU75 that is allocated to Service A is recognised over the two-year service period. The consideration of CU25 that is allocated to the option is deferred until Service B is transferred to the customer or the option expires.

Six months after executing the contract, Customer exercises the option to purchase two years of Service B for CU300. Following the requirements for changes in the transaction price, the consideration of CU300 related to Service B is added to the amount previously allocated to the option to purchase Service B (i.e., CU300 + CU25 = CU325). This is recognised as revenue over the two-year period in which Service B is transferred. Entity is able to allocate the additional consideration received for the exercise of the option to Service B because it specifically relates to Entity's efforts to satisfy the performance obligation and the allocation in this manner is consistent with the standard's allocation objective.

Under the second approach, which treats the exercise of a material right as a contract modification (i.e., because there a change in the scope and/or price of a contract), an entity follows the contract modification requirements in IFRS 15.18-21 (see section 3.4).

Since more than one approach would be acceptable, TRG members generally agreed that an entity needs to consider which approach is most appropriate, based on the facts and circumstances, and consistently apply that approach to similar contracts.

Question 4-25: Is an entity required to evaluate whether a customer option that provides a material right includes a significant financing component? If so, how would entities perform this evaluation? [TRG meeting 30 March 2015 – Agenda paper no.32]

TRG members generally agreed that an entity has to evaluate whether a material right includes a significant financing component (see section 5.5) in the same way that it evaluates any other performance obligation. This evaluation requires judgement and consideration of the facts and circumstances.

On this question, the TRG agenda paper discussed a factor that may be determinative in this evaluation. IFRS 15.62(a) indicates that if a customer provides advance payment for a good or service, but the customer can choose when the good or service is transferred, no significant financing component exists. As a result, if the customer can choose when to exercise the option, it is unlikely that there will be a significant financing component.

Frequently asked questions (cont'd)

Question 4-26: How should revenue be recognised for customer options for additional goods or services that represent a material right but do not have an expiration date (i.e., can an entity recognise breakage for these options)?

Stakeholders have asked this question because IFRS 15.B40 states that an entity should recognise revenue allocated to options that are material rights when the future goods or services resulting from the option are transferred or when the option expires. However, in some cases, options may be perpetual and not have an expiration date. For example, loyalty points likely provide a material right to a customer and, sometimes, these points do not expire. We believe an entity may apply the requirements in IFRS 15 on customers' unexercised rights (or breakage), which are discussed in section 7.9 (i.e., IFRS 15.B44-B47). That is, we believe it is appropriate for revenue allocated to a customer option that does not expire to be recognised at the earlier of when the future goods or services, resulting from the option, are transferred or, if the goods or services are not transferred, when the likelihood of the customer exercising the option becomes remote.

4.7 Sale of products with a right of return

An entity may provide its customers with a right to return a transferred product. A right of return may be contractual, an implicit right that exists due to the entity's customary business practice or a combination of both (e.g., an entity has a stated return period, but generally accepts returns over a longer period). A customer exercising its right to return a product may receive a full or partial refund, a credit that can be applied to amounts owed, a different product in exchange or any combination of these items.

Offering a right of return in a sales agreement obliges the selling entity to stand ready to accept any returned product. IFRS 15.B22 states that such an obligation does not represent a performance obligation. Instead, the Board concluded that an entity makes an uncertain number of sales when it provides goods with a return right. That is, until the right of return expires, the entity is not certain how many sales will fail. Therefore, an entity does not recognise revenue for sales that are expected to fail as a result of the customer exercising its right to return the goods.[168] Instead, the potential for customer returns needs to be considered when an entity estimates the transaction price because potential returns are a component of variable consideration. This concept is discussed further in section 5.4.

IFRS 15.B26 clarifies that exchanges by customers of one product for another of the same type, quality, condition and price (e.g., one colour or size for another) are not considered returns for the purposes of applying the standard. Furthermore, contracts in which a customer may return a defective product in exchange for a functioning product need to be evaluated in accordance with the requirements on warranties included in IFRS 15. See further discussion on warranties in section 9.1.

[168] IFRS 15.BC364.

5. Determine the transaction price (updated October 2018)

The standard provides the following requirements for determining the transaction price:

Extract from IFRS 15

Determining the transaction price

47. An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

48. The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. When determining the transaction price, an entity shall consider the effects of all of the following:

(a) variable consideration (see paragraphs 50–55 and 59);

(b) constraining estimates of variable consideration (see paragraphs 56–58);

(c) the existence of a significant financing component in the contract (see paragraphs 60–65);

(d) non-cash consideration (see paragraphs 66–69); and

(e) consideration payable to a customer (see paragraphs 70–72).

49. For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed or modified.

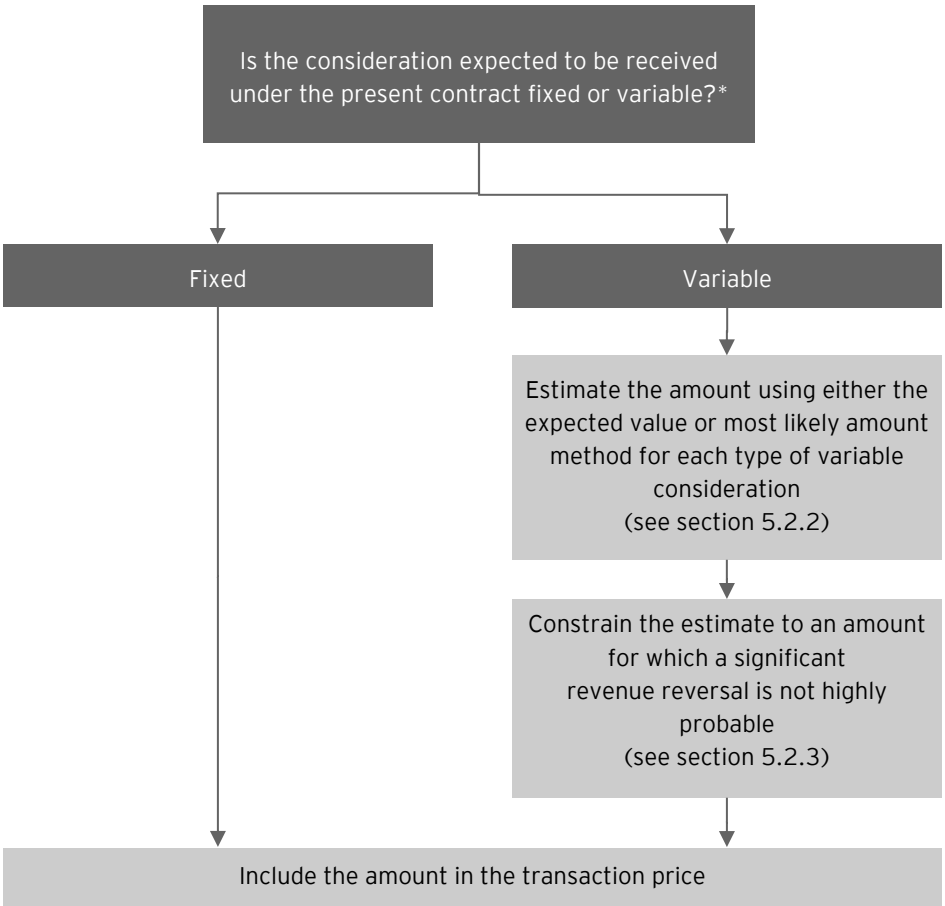
The transaction price is based on the amount to which the entity expects to be 'entitled'. This is meant to reflect the amount to which the entity has rights under the present contract (see section 3.2 on contract enforceability and termination clauses). That is, the transaction price does not include estimates of consideration resulting from future change orders for additional goods or services. The amount to which the entity expects to be entitled also excludes amounts collected on behalf of another party, such as sales taxes. As noted in the Basis for Conclusions, the Board decided that the transaction price would not include the effects of the customer's credit risk, unless the contract includes a significant financing component (see section 5.5).[169]

The IASB also clarified in the Basis for Conclusions that entities may have rights under the present contract to amounts that are to be paid by parties other than the customer and, if so, these amounts would be included in the transaction price. For example, in the healthcare industry, an entity may be entitled under the present contract to payments from the patient, insurance companies and or/government organisations. If that is the case, the total amount to which the entity expects to be entitled needs to be included in the transaction price, regardless of the source.[170]

[169] IFRS 15.BC185.
[170] IFRS 15.BC187.

Determining the transaction price is an important step in applying IFRS 15 because this amount is allocated to the identified performance obligations and is recognised as revenue when (or as) those performance obligations are satisfied. In many cases, the transaction price is readily determinable because the entity receives payment when it transfers promised goods or services and the price is fixed (e.g., a restaurant's sale of food with a no refund policy). Determining the transaction price is more challenging when it is variable, when payment is received at a time that differs from when the entity provides the promised goods or services or when payment is in a form other than cash. Consideration paid or payable by the entity to the customer may also affect the determination of the transaction price.

The following flow chart illustrates how an entity would determine the transaction price if the consideration to be received is fixed or variable:



* Consideration expected to be received under the contract can be variable even when the stated price in the contract is fixed. This is because the entity may be entitled to consideration only upon the occurrence or non-occurrence of a future event (see section 5.2.1).

Frequently asked questions

Question 5-1: How would entities determine the presentation of amounts billed to customers (e.g., shipping and handling, expenses or cost reimbursements and taxes under the standards (i.e., as revenue or as a reduction of costs)? [18 July 2014 TRG meeting; TRG agenda paper no. 2]

See response to Question 4-13 in section 4.4.4.

5.1 Presentation of sales (and other similar) taxes (updated October 2018)

Sales and excise taxes are those levied by taxing authorities on the sales of goods or services. Although various names are used for these taxes, sales taxes generally refer to taxes levied on the purchasers of the goods or services and excise taxes refer to those levied on the sellers of goods or services.

The standard includes a general principle that an entity determines the transaction price exclusive of amounts collected on behalf of third parties (e.g., some sales taxes). Following the issuance of the standard, some stakeholders informed the Board's staff that there could be multiple interpretations regarding whether certain items that are billed to customers need to be presented as revenue or as a reduction of costs. Examples of such amounts include shipping and handling fees, reimbursements of out-of-pocket expenses and taxes or other assessments collected and remitted to government authorities.

At the July 2014 TRG meeting, members of the TRG generally agreed that the standard is clear that any amounts that are not collected on behalf of third parties would be included in the transaction price (i.e., revenue). That is, if the amounts were earned by the entity in fulfilling its performance obligations, the amounts are included in the transaction price and recorded as revenue.

Several TRG members noted that this would require entities to evaluate taxes collected in all jurisdictions in which they operate to determine whether a tax is levied on the entity or the customer. In addition, TRG members indicated that an entity would apply the principal versus agent application guidance (see section 4.4 above) when it is not clear whether the amounts are collected on behalf of third parties. This could result in amounts billed to a customer being recorded net of costs incurred (i.e., on a net basis). Determining whether an entity is a principal (i.e., directly liable for the tax obligation) or an agent (i.e., collecting the tax on behalf of the tax authority) in relation to such taxes will depend on the specific facts and circumstances, including the intention and underlying characteristics of the tax in the particular jurisdiction.

FASB differences

The FASB's standard allows an entity to make an accounting policy election to present revenue net of certain types of taxes (including sales, use, value-added and some excise taxes) with a requirement for preparers to disclose the policy. As a result, entities that make this election do not need to evaluate taxes that they collect (e.g., sales, use, value-added, some excise taxes) in all jurisdictions in which they operate in order to determine whether a tax is levied on the entity or the customer. This type of evaluation would otherwise be necessary to meet the standard's requirement to exclude from the transaction price any "amounts collected on behalf of third parties (for example, some sales taxes)".[171]

The IASB decided not to include a similar accounting policy election in IFRS 15, noting that the requirements of IFRS 15 are consistent with legacy IFRS requirements.[172] As a result, differences may arise between entities applying IFRS 15 and those applying ASC 606.

[171] IFRS 15.47.
[172] IFRS 15.BC188D.

5.2 Variable consideration

The transaction price reflects an entity's expectations about the consideration to which it will be entitled to receive from the customer. The standard provides the following requirements for determining whether consideration is variable and, if so, how it would be treated under the model:

Extract from IFRS 15

50. If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

51. An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.

52. The variability relating to the consideration promised by a customer may be explicitly stated in the contract. In addition to the terms of the contract, the promised consideration is variable if either of the following circumstances exists:

(a) the customer has a valid expectation arising from an entity's customary business practices, published policies or specific statements that the entity will accept an amount of consideration that is less than the price stated in the contract. That is, it is expected that the entity will offer a price concession. Depending on the jurisdiction, industry or customer this offer may be referred to as a discount, rebate, refund or credit.

(b) other facts and circumstances indicate that the entity's intention, when entering into the contract with the customer, is to offer a price concession to the customer.

These concepts are discussed in more detail below.

5.2.1 Forms of variable consideration (updated September 2019)

IFRS 15.51 describes 'variable consideration' broadly to include discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses (e.g., meeting specified performance conditions where there is uncertainty about the outcome) and penalties. Variable consideration can result from explicit terms in a contract to which the parties to the contract agreed or can be implied by an entity's past business practices or intentions under the contract. It is important for entities to appropriately identify the different instances of variable consideration included in a contract because the second step of estimating variable consideration requires entities to apply a constraint (as discussed further in section 5.2.3) to all variable consideration.

The Board noted in the Basis for Conclusions that consideration can be variable even when the stated price in the contract is fixed. This is because the entity may be entitled to consideration only upon the occurrence or non-occurrence of a future event.[173] For example, IFRS 15's description of variable consideration includes amounts resulting from variability due to customer refunds or returns. As a result, a contract to provide a customer with 100 widgets at a fixed price per widget would be considered to include a variable component if the customer has the right to return the widgets (see section 5.4.1).

In many transactions, entities have variable consideration as a result of rebates and/or discounts on the price of products or services they provide to customers once the customers meet specific volume thresholds. The standard contains the following example relating to volume discounts:

Extract from IFRS 15

Example 24—Volume discount incentive (IFRS 15.IE124-IE128)

An entity enters into a contract with a customer on 1 January 20X8 to sell Product A for CU100 per unit. If the customer purchases more than 1,000 units of Product A in a calendar year, the contract specifies that the price per unit is retrospectively reduced to CU90 per unit. Consequently, the consideration in the contract is variable.

For the first quarter ended 31 March 20X8, the entity sells 75 units of Product A to the customer. The entity estimates that the customer's purchases will not exceed the 1,000-unit threshold required for the volume discount in the calendar year.

The entity considers the requirements in paragraphs 56–58 of IFRS 15 on constraining estimates of variable consideration, including the factors in paragraph 57 of IFRS 15. The entity determines that it has significant experience with this product and with the purchasing pattern of the entity. Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (ie CU100 per unit) will not occur when the uncertainty is resolved (ie when the total amount of purchases is known). Consequently, the entity recognises revenue of CU7,500 (75 units × CU100 per unit) for the quarter ended 31 March 20X8.

In May 20X8, the entity's customer acquires another company and in the second quarter ended 30 June 20X8 the entity sells an additional 500 units of Product A to the customer. In the light of the new fact, the entity estimates that the customer's purchases will exceed the 1,000-unit threshold for the calendar year and therefore it will be required to retrospectively reduce the price per unit to CU90.

Consequently, the entity recognises revenue of CU44,250 for the quarter ended 30 June 20X8. That amount is calculated from CU45,000 for the sale of 500 units (500 units × CU90 per unit) less the change in transaction price of CU750 (75 units × CU10 price reduction) for the reduction of revenue relating to units sold for the quarter ended 31 March 20X8 (see paragraphs 87 and 88 of IFRS 15).

[173] IFRS 15.BC191.

How we see it

IFRS 15 requires entities to disclose how they estimate variable consideration when determining the transaction price in contracts with customers, including the following:

- Significant payment terms (including whether the consideration is variable and whether the estimate is typically constrained, rights of return, etc.)
- Significant judgements used in determining the transaction price, including information about methods, inputs and assumptions used to estimate variable consideration and assess whether the estimate is constrained

As a result, entities may need to explain the different forms of variable consideration included in their contracts with customers. Entities, therefore, need to carefully consider and identify all forms of variable consideration when they determine the transaction price for their customer contracts and review their disclosures to verify that they meet the disclosure requirements in IFRS 15.119, 123 and 126 (see section 10.5 for further discussion of disclosure requirements).

Frequently asked questions

Question 5-2: Should volume rebates and/or discounts on goods or services be accounted for as variable consideration or as customer options to acquire additional goods or services at a discount?

See response to Question 4-20 in section 4.6.

Question 5-3: How would an entity distinguish between a contract that contains an option to purchase additional goods or services and a contract that includes variable consideration based on a variable quantity (e.g., a usage-based fee)? [TRG Meeting 9 November 2015 – Agenda paper no. 48]

See response to Question 4-17 in section 4.6.

Question 5-4: Should liquidated damages, penalties or compensation from other similar clauses be accounted for as variable consideration or warranty provisions under the standard?

Most liquidated damages, penalties and similar payments are accounted for as variable consideration. However, in limited situations, we believe that amounts that are based on the actual performance of a delivered good or service may be considered similar to warranty payments (e.g., in situations in which an entity pays the customer's direct costs to remedy a defect).

Some contracts provide for liquidated damages, penalties or other damages if an entity fails to deliver future goods or services or if the goods or services fail to meet certain specifications. IFRS 15.51 includes 'penalties' as an example of variable consideration and describes how promised consideration in a contract can be variable if the right to receive the consideration is contingent on the occurrence or non-occurrence of a future event (e.g., the contract specifies that an entity pays a penalty if it fails to perform according to the agreed upon terms).

Frequently asked questions (cont'd)

Penalties and other clauses that are considered similar to warranty provisions would be accounted for as:

(a) Consideration paid or payable to a customer (which may be variable consideration, see section 5.7)

Or

(b) An assurance-type or service-type warranty (see section 9.1 on warranties)

Cash fines or penalties paid to a customer would generally be accounted for under the requirements on consideration payable to a customer. However, we believe there may be situations in which it is appropriate to account for cash payments as an assurance-type warranty (e.g., an entity's direct reimbursement to the customer for costs paid by the customer to a third party for repair of a product).

Example 20 in the standard illustrates a performance penalty that is a form of variable consideration.[174]

In 2019, the IFRS IC received a request asking whether an airline accounts for its obligation to compensate customers for delayed or cancelled flights as variable consideration or, separate from the contract, by applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

When the issue was discussed at the September 2019 meeting, the IFRS IC observed that the compensation for delays or cancellations gives rise to variable consideration because it:

- Relates directly to the entity's fulfilment of its performance obligation (i.e., failure to perform as promised triggers the compensation payment)

  And

- Does not represent compensation for harm or damage caused by the entity's products (and, therefore, IFRS 15.B33 does not apply).

The IFRS IC also observed that the compensation payment was similar to penalties for delayed transfer of an asset, which also gives rise to variable consideration, as is illustrated in Example 20 of the standard.[175]

Question 5-5: If a contract includes an undefined quantity of outputs, but the contractual rate per unit is fixed, is the consideration variable? [TRG meeting 13 July 2015 – Agenda paper no. 39]

Yes. TRG members generally agreed that if a contract includes an unknown quantity of tasks, throughout the contract period, for which the entity has enforceable rights and obligations (i.e., the unknown quantity of tasks is not an option to purchase additional goods or services, as described in Question 4-17 in section 4.6) and the consideration received is contingent upon the quantity completed, the total transaction price would be variable. This is because the contract has a range of possible transaction prices and the ultimate consideration depends on the occurrence or non-occurrence of a future event (e.g., customer usage), even though the rate per unit is fixed.

The TRG agenda paper on this topic noted that an entity would need to consider contractual minimums (or other clauses) that would make some or all of the consideration fixed.

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[174] IFRS 15.IE102-IE104.

[175] *IFRIC Update*, September 2019, available on the IASB's website.

Frequently asked questions (cont'd)

Question 5-6: If a contract is denominated in a currency other than that of the entity's functional currency, should changes in the contract price due to exchange rate fluctuations be accounted for as variable consideration?

We believe that changes to the contract price due to exchange rate fluctuations do not result in variable consideration. These price fluctuations are a consequence of entering into a contract that is denominated in a foreign currency, rather than a result of a contract term like a discount or rebate or one that depends on the occurrence or non-occurrence of a future event, as described in IFRS 15.51.

The variability resulting from changes in foreign exchange rates relates to the form of the consideration (i.e., it is in a currency other than the entity's functional currency). As such, we believe that it would not be considered variable consideration when determining the transaction price. This variability may, instead, need to be accounted for in accordance with IFRS 9 if it is a separable embedded derivative. Otherwise, an entity would account for this variability in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

IFRIC 22 *Foreign Currency Transactions and Advance Consideration* specifies that when consideration denominated in a foreign currency is recognised in advance of the associated revenue, the appropriate application of IAS 21 is to measure the revenue using the exchange rate at the date the advanced receipt is recognised, normally the payment date.[176]

Question 5-7: How would an entity account for price protection or price matching clauses included in a contract with a customer?

Consideration subject to price protection or price matching clauses that require an entity to refund a portion of the consideration to the customer in certain situations must be accounted for as variable consideration under IFRS 15. That is, we believe that, if an entity is required to retrospectively apply lower prices to previous purchases made by a customer (or has a past business practice of doing so, even if the contractual terms would only require prospective application), the consideration would be accounted for as variable consideration.

Examples include contracts between an entity and a customer that provide, either as a matter of formal agreement or due to an entity's business practices, that the entity will refund or provide a credit equal to a portion of the original purchase price towards future purchases if the entity subsequently reduces its price for a previously delivered product and the customer still has inventory of that product on hand. An entity may also offer to match a competitor's price and provide a refund of the difference if the customer finds the same product offered by one of the entity's competitors for a lower price during a specified period of time following the sale.

Contracts with customers also may contain 'most favoured nation' or 'most favoured customer' clauses under which the entity guarantees that the price of any products sold to the customer after contract inception will be the lowest price the entity offers to any other customer. How consideration from such contracts would be accounted for under IFRS 15 depends on the terms of the clause (i.e., whether the price protection is offered prospectively or retrospectively).

[176] IFRIC 22.8

Frequently asked questions (cont'd)

We believe that clauses that require an entity to prospectively provide a customer with its best prices on any purchases of products after the execution of a contract have no effect on the revenue recognised for goods or services already transferred to the customer (i.e., the consideration would not be accounted for as variable consideration).

However, if an entity is required to retrospectively apply lower prices to previous purchases made by a customer (or has a past business practice of doing so even if the written contractual terms would only require prospective application), we believe the contract includes a form of price protection and the consideration subject to this provision would be accounted for as variable consideration, as discussed above. We note that these clauses may be present in arrangements with governmental agencies. For example, an entity may be required to monitor discounts given to comparable customers during the contract period and to refund the difference between what was paid by the government and the price granted to comparable commercial customers.

Question 5-8: Do early payment (or prompt payment) discounts represent a form of variable consideration?

Yes. Contracts with customers may include a discount for early payment (or 'prompt payment' discount) under which the customer can pay less than an invoice's stated amount if the payment is made within a certain period of time. For example, a customer might receive a 2% discount if the payment is made within 15 days of receipt (if payment is otherwise due within 45 days of receipt). Because the amount of consideration to be received by the entity would vary depending on whether the customer takes advantage of the discount, the transaction price is variable.

5.2.1.A Implicit price concessions (updated October 2020)

For some contracts, the stated price has easily identifiable variable components. However, for other contracts, the consideration may be variable because the facts and circumstances indicate that the entity may accept a lower price than the amount stated in the contract (i.e., it expects to provide an implicit price concession). This could be a result of the customer having a valid expectation that the entity will reduce its price based on the entity's customary business practices, published policies or statements made by the entity.

An implicit price concession could also result from other facts and circumstances indicating that the entity intended to offer a price concession to the customer when it entered into the contract. For example, an entity may accept a lower price than the amount stated in the contract to develop or enhance a customer relationship or because the incremental cost of providing the service to the customer is not significant and the consideration it expects to collect provides a sufficient margin.

An entity deducts from its contract price any estimated price concessions to derive the transaction price at contract inception (i.e., the amount the entity expects to be entitled in exchange for the goods or services that will be transferred to the customer). The IFRS 15 collectability assessment is then performed on the transaction price (see section 3.1.5). An entity also has to assess any contract assets or trade receivables arising from an IFRS 15 contract under the expected credit loss model in IFRS 9.

The standard provides the following example of when an implicit price concession exists and, as a result, the transaction price is not the amount stated in the contract:

Extract from IFRS 15

Example 2 — Consideration is not the stated price – implicit price concession (IFRS 15.IE7-IE9)

An entity sells 1,000 units of a prescription drug to a customer for promised consideration of CU1 million. This is the entity's first sale to a customer in a new region, which is experiencing significant economic difficulty. Thus, the entity expects that it will not be able to collect from the customer the full amount of the promised consideration. Despite the possibility of not collecting the full amount, the entity expects the region's economy to recover over the next two to three years and determines that a relationship with the customer could help it to forge relationships with other potential customers in the region.

When assessing whether the criterion in paragraph 9(e) of IFRS 15 is met, the entity also considers paragraphs 47 and 52(b) of IFRS 15. Based on the assessment of the facts and circumstances, the entity determines that it expects to provide a price concession and accept a lower amount of consideration from the customer. Accordingly, the entity concludes that the transaction price is not CU1 million and, therefore, the promised consideration is variable. The entity estimates the variable consideration and determines that it expects to be entitled to CU400,000.

The entity considers the customer's ability and intention to pay the consideration and concludes that even though the region is experiencing economic difficulty, it is probable that it will collect CU400,000 from the customer. Consequently, the entity concludes that the criterion in paragraph 9(e) of IFRS 15 is met based on an estimate of variable consideration of CU400,000. In addition, on the basis of an evaluation of the contract terms and other facts and circumstances, the entity concludes that the other criteria in paragraph 9 of IFRS 15 are also met. Consequently, the entity accounts for the contract with the customer in accordance with the requirements in IFRS 15.

Examples 3 and 23 from the standard (see section 5.2.3) also illustrate situations where an implicit price concession exists at contract inception and, therefore, the transaction price evaluated for collectability is not the amount stated in the contract due to implicit price concessions that exist at contract inception.

Variable consideration may also result from extended payment terms in a contract and any resulting uncertainty about whether the entity will be willing to accept a lower payment amount in the future. That is, an entity has to evaluate whether the extended payment terms represent an implied price concession because the entity does not intend to collect all amounts due in future periods. Offering extended payment terms may also indicate that the contract includes a significant financing component (see section 5.5).

Variable consideration versus credit risk

As discussed in section 3.1.5, entities need to determine at contract inception whether they expect to collect a lower amount of consideration than the amount stated in the contract. In the Basis for Conclusions, the IASB acknowledged that, in some cases, it may be difficult to determine whether the entity has implicitly offered a price concession (i.e., variable consideration) or whether the entity has chosen to accept the risk of the customer defaulting on the contractually agreed consideration (i.e., impairment losses under IFRS 9).[177] The Board did not develop detailed application guidance to assist in distinguishing between price concessions (recognised as variable consideration, within revenue) and an expected credit loss to be accounted for as an impairment loss under IFRS 9 (i.e., outside of revenue). Therefore, entities need to consider all relevant facts and circumstances when analysing situations in which an entity is willing to accept a lower price than the amount stated in the contract.

We believe the following factors may suggest that the entity has implicitly offered a price concession to the customer:

- The entity has an established business practice that indicates it is willing to accept consideration less than its contractually stated prices. For example, an entity routinely accepts reduced payments on services for which it earns high margins, indicating that it is willing to accept an amount of consideration that is less than the contract price.
- The entity has a history of not enforcing its contractual rights to promised consideration in similar contracts under similar circumstances such that customers expect the entity to offer price concessions. For example, the customer has a valid expectation that the entity is willing to accept a lower amount of consideration than the contractually stated price based on its past experience with the entity.
- The entity is willing to enter into a contract with a customer even though facts and circumstances indicate that the customer intends to pay an amount of consideration that is less than the contractually stated price. For example, the entity willingly enters into a contract expecting that it will receive less than the stated contract price, implicitly reducing the transaction price to the expected lesser consideration.

Appropriately distinguishing between price concessions (i.e., reductions of revenue) and customer credit risk (i.e., impairment loss) for collectability concerns, that were known at contract inception, is also important because it affects whether a valid contract exists (see section 3.1.5). If an entity determines at contract inception that a contract includes a price concession (i.e., variable consideration), the estimated amount of the concession is reflected in the transaction price (i.e., as a reduction of the stated contract price). As illustrated in Example 2 in IFRS 15 in the extract above (and also in Examples 3 and 23 in IFRS 15, see section 5.2.3), entities may estimate a transaction price that is significantly lower than the stated invoice or contractual amount, but still consider the difference between those amounts to be variable consideration (e.g., a price concession), rather than a collectability issue that would result in expected credit losses.

After the entity has determined the amount to assess for collectability under IFRS 15.9(e), it also has to apply the requirements in IFRS 9 to account for any expected credit losses for the receivable (or contract asset) that is recorded (i.e., after consideration of any variable consideration, such as an implicit price

[177] IFRS 15.BC194.

concession). Also, it should present any resulting impairment loss as an expense under IFRS 9 (i.e., not as a reduction of the transaction price). This is illustrated in an example from a January 2015 TRG agenda paper included in Question 3-4 in section 3.1.5.[178]

After contract inception, entities need to update both their estimate of variable consideration under IFRS 15 (see section 5.2.4) and their assessment of expected credit losses under IFRS 9, respectively, at the end of each reporting period. When the amount an entity expects to collect changes after contract inception, the entity may need to exercise significant judgement to determine whether that change is due to: (1) a change in estimate of the variable consideration identified at contract inception (and, therefore, would be accounted for as a change in the transaction price, as discussed in section 6.5); or (2) an identifiable credit event (e.g., a known or expected decline in a customer's operations, a known or expected bankruptcy filing or other financial reorganisation or the request for a concession on payment terms due to economic reasons) that would trigger a credit loss to be accounted for as an impairment loss under IFRS 9 (i.e., outside revenue). It is likely that this determination will require entities to establish policies to differentiate between price concessions and customer credit events, both at contract inception and as facts and circumstances change over the life of the contract. Such assessments may have been needed during the coronavirus pandemic because customers' ability and intent to pay were affected and/or entities were more willing to accept partial payment or extended payment terms. Importantly, if the parties need to change the terms of contracts with existing customers as a result, entities need to determine whether there is a contract modification (see section 3.4).

When making this evaluation, the entity needs to consider the facts and circumstances that led to its change in expectation about the amount it expects to collect. For example, if an entity that had contemplated an implicit price concession at contract inception decides to increase the amount of the concession it is willing to provide to further enhance the relationship with its customer, it may conclude that this is variable consideration. Therefore, it would be a reduction of the transaction price, i.e., revenue. In contrast, if the entity determines it will collect less consideration than it originally estimated due to its customer filing for bankruptcy, it is likely the entity would conclude that this is an impairment loss to be accounted for outside of IFRS 15 (i.e., there would be no adjustment to revenue).

[178] TRG Agenda paper no. 13, *Collectibility*, dated 26 January 2015.

An entity may need to make the following assessments when evaluating changes in expectations about the amount it expects to collect after contract inception:

- Reassess collectability of the remaining contract consideration if the entity concludes that the change in expectation is due to a significant change in facts and circumstances (see Question 3-5)
- Consider whether the change in expectation is due to a contract modification. A contract modification is defined in IFRS 15 as "a change in scope or price (or both) of a contract that is approved by the parties to a contract".[179] See section 3.4 for further discussion on contract modifications
- Consider whether the change in expectation indicates that the entity needs to assess related capitalised costs to obtain or fulfil a contract for impairment (see section 9.3)

How we see it

Determining, at contract inception, whether an entity has implicitly offered a price concession (i.e., variable consideration) or whether it has accepted the risk that a customer may default on the contractually agreed-upon consideration (i.e., impairment losses) may require significant judgement. The entity needs to consider its specific facts and circumstances, including its customary business practices and any other indicators about whether it intended at contract inception to offer a price concession to the customer.

Entities may also need to apply judgement when determining whether a change in the amount it expects to collect after contract inception is due to a change in an estimate of variable consideration (and, therefore, needs to be accounted for as change in transaction price) or due to a change in estimated credit losses that would be accounted for as impairment loss.

5.2.2 Estimating variable consideration (updated September 2019)

If a contract with a customer includes variable consideration, IFRS 15.50 (see section 5.2) states that "an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer". Entities are generally required to estimate variable consideration at contract inception and at the end of each reporting period (see section 5.2.4 for reassessment requirements). In Question 5-9, we discuss limited situations in which the estimation of variable consideration may not be required.

Variable consideration generally needs to be estimated, instead of waiting for the variable consideration to be received or known with a high degree of certainty (e.g., upon receipt of a report from a customer detailing the amount of revenue due to the entity). For example, it would not be acceptable for entities that sell their products through distributors or resellers to wait until the end-sale has occurred if the only uncertainty is the variability in the pricing. This is because IFRS 15 requires an entity to estimate the variable consideration (the end-sales price in our example) based on the information available, taking into consideration the effect of the constraint on variable consideration (see section 5.2.3), unless one of the limited situations discussed in Question 5-9 occurs.

[179] IFRS 15.18.

An entity is required to estimate variable consideration using either the 'expected value' or the 'most likely amount' method, as described in the standard:

Extract from IFRS 15

53. An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

(a) The expected value—the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.

(b) The most likely amount—the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

54. An entity shall apply one method consistently throughout the contract when estimating the effect of an uncertainty on an amount of variable consideration to which the entity will be entitled. In addition, an entity shall consider all the information (historical, current and forecast) that is reasonably available to the entity and shall identify a reasonable number of possible consideration amounts. The information that an entity uses to estimate the amount of variable consideration would typically be similar to the information that the entity's management uses during the bid-and-proposal process and in establishing prices for promised goods or services.

An entity is required to choose between the expected value method and the most likely amount method based on which method better predicts the amount of consideration to which it will be entitled. That is, the method selected is not meant to be a 'free choice'. Rather, an entity must select the method that is best suited, based on the specific facts and circumstances of the contract.

An entity applies the selected method consistently to each type of variable consideration throughout the contract term and updates the estimated variable consideration at the end of each reporting period. Once it selects a method, an entity is required to apply that method consistently for similar types of variable consideration in similar types of contracts. In the Basis for Conclusions, the Board noted that a contract may contain different types of variable consideration.[180] As such, it may be appropriate for an entity to use different methods (i.e., expected value or most likely amount) for estimating different types of variable consideration within a single contract.

[180] IFRS 15.BC202.

Entities determine the expected value of variable consideration using the sum of probability-weighted amounts in a range of possible amounts under the contract. To do this, an entity identifies the possible outcomes of a contract and the probabilities of those outcomes. The Board indicated in the Basis for Conclusions that the expected value method may better predict expected consideration when an entity has a large number of contracts with similar characteristics.[181] This method may also better predict consideration when an entity has a single contract with a large number of possible outcomes. The IASB clarified that an entity preparing an expected value calculation is not required to consider all possible outcomes, even if the entity has extensive data and can identify many possible outcomes. Instead, the IASB noted in the Basis for Conclusions that, in many cases, a limited number of discrete outcomes and probabilities can provide a reasonable estimate of the expected value.[182]

Illustration 5-1 — Estimating the transaction price using the expected value method

Entity A enters into contracts with customers to construct commercial buildings. The contracts include similar terms and conditions and contain a fixed fee plus variable consideration for a performance bonus related to the timing of Entity A's completion of the construction. Based on Entity A's historical experience, the expected bonus amounts and associated probabilities for achieving each bonus are, as follows:

Bonus amount	Probability of outcome
CU0	25%
CU100,000	50%
CU150,000	25%

Entity A determines that using the expected value method would better predict the amount of consideration to which it will be entitled because it has a large number of contracts that have characteristics that are similar to the new contract. Under the expected value method, Entity A estimates variable consideration of CU87,500, as follows:

Bonus amount (a)	Probability of outcome (b)	Expected value amount (a × b)
CU0	25%	CU0
CU100,000	50%	CU50,000
CU150,000	25%	CU37,500
	Total	**CU87,500**

Entity A needs to consider the effect of applying the constraint on variable consideration (see section 5.2.3).

[181] IFRS 15.BC200.
[182] IFRS 15.BC201.

Entities determine the most likely amount of variable consideration using the single most likely amount in a range of possible consideration amounts. The Board indicated in the Basis for Conclusions that the most likely amount method may be the better predictor when the entity expects to be entitled to one of two possible amounts.[183] For example, a contract in which an entity is entitled to receive all or none of a specified performance bonus, but not a portion of that bonus.

Illustration 5-2 — Estimating the transaction price using the most likely amount

Entity A enters into a six-month advertising campaign agreement (CU500,000 fixed fee) that also includes a potential CU100,000 performance bonus linked to certain goals. Entity A estimates that it is 90% likely to receive the entire performance bonus and 10% likely to receive none of the bonus.

Because of the binary nature of the outcome (i.e., the entity will either receive the performance bonus or not receive it), Entity A determines that the most likely amount method is the better predictor of the amount to which it expects to be entitled. Because it is 90% probable that Entity A will receive the CU100,000 performance bonus, Entity A estimates the most likely amount it will receive is CU600,000 (i.e., CU500,000 fixed fee plus the entire CU100,000 bonus).

However, Entity A also needs to consider the effect of applying the constraint on variable consideration (see section 5.2.3) and determine whether it is highly probable that a significant reversal will not occur if it includes the entire CU100,000 performance bonus in the transaction price.

The standard states that when applying either of these methods, an entity considers all information (historical, current and forecast) that is reasonably available to the entity. Some stakeholders questioned whether an entity would be applying the portfolio approach practical expedient in IFRS 15.4 (see section 3.3.1) when considering evidence from other, similar contracts to develop an estimate of variable consideration using an expected value method. TRG members discussed this question and generally agreed that an entity would not be applying the portfolio approach practical expedient if it used a portfolio of data from its historical experience with similar customers and/or contracts. TRG members noted that an entity could choose to apply the portfolio approach practical expedient, but would not be required to do so.[184] Use of this practical expedient requires an entity to assert that it does not expect the use of the expedient to differ materially from applying the standard to an individual contract. The TRG agenda paper noted that using a portfolio of data is not equivalent to using the portfolio approach practical expedient, so entities that use the expected value method to estimate variable consideration would not be required to assert that the outcome from the portfolio is not expected to materially differ from an assessment of individual contracts.

[183] IFRS 15.BC200.

[184] TRG Agenda paper no. 38, *Portfolio Practical Expedient and Application of Variable Consideration Constraint*, dated 13 July 2015.

Frequently asked questions

Question 5-9: Are there any situations in which an entity would not have to estimate variable consideration at contract inception under IFRS 15?

An entity may not have to estimate variable consideration at the inception of a contract in the following situations:

- **Allocation of variable consideration exception** — When the terms of a variable payment relate to an entity's efforts to satisfy a specific part of a contract (i.e., one or more, but not all, performance obligations or distinct goods or services promised in a series) and allocating the consideration to this specific part is consistent with the overall allocation objectives of the standard, IFRS 15 requires variable consideration to be allocated entirely to that specific part of a contract. As a result, variable consideration would not be estimated for the purpose of recognising revenue. For example, an entity that provides a series of distinct hotel management services and receives a variable fee based on a fixed percentage of rental revenue would need to allocate the percentage of monthly rental revenue entirely to the period in which the consideration is earned if the criteria to use this allocation exception are met. See section 6.3 for further discussion of the variable consideration allocation exception.
- **The 'right to invoice' practical expedient** — When an entity recognises revenue over time, the right to invoice practical expedient allows it to recognise revenue as invoiced if the entity's right to payment is for an amount that corresponds directly with the value to the customer of the entity's performance to date. For example, an entity may not be required to estimate the variable consideration for a three-year service contract under which it has a right to invoice the customer a fixed amount for each hour of service rendered, provided that fixed amount reflects the value to the customer. See section 7.1.4.A for further discussion of the right to invoice practical expedient.
- **Sales-based and usage-based royalties on licences of intellectual property recognition constraint** — The standard provides explicit application guidance for recognising consideration from sales-based and usage-based royalties provided in exchange for licences of intellectual property. The standard states that an entity recognises sales-based and usage-based royalties as revenue at the later of when: (1) the subsequent sales or usage occurs; or (2) the performance obligation to which some, or all, of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied). In many cases, using this application guidance results in the same pattern of revenue recognition as fully constraining the estimate of variable consideration associated with the future royalty stream. However, in cases where an entity is required to allocate sales-based or usage-based royalties to separate performance obligations in a contract, it may need to include expected royalties in its estimate of the stand-alone selling price of one or more of the performance obligations. See section 8.5 for further discussion about sales-based and usage-based royalties related to licences of intellectual property.

5.2.3 Constraining estimates of variable consideration (updated September 2019)

Before an entity can include any amount of variable consideration in the transaction price, it must consider whether the amount of variable consideration is required to be constrained. The Board explained in the Basis for Conclusions that it created this constraint on variable consideration to address concerns raised by many constituents that the standard could otherwise require recognition of revenue before there was sufficient certainty that the amounts recognised would faithfully depict the consideration to which an entity expects to be entitled in exchange for the goods or services transferred to a customer.[185]

The IASB explained in the Basis for Conclusions that it did not intend to eliminate the use of estimates from the revenue recognition standard. Instead, it wanted to make sure the estimates are robust and result in useful information.[186] Following this objective, the Board concluded that it was appropriate to include estimates of variable consideration in revenue only when an entity has a 'high degree of confidence' that revenue will not be reversed in a subsequent reporting period.

Therefore, as the following extract from the standard states, the constraint is aimed at preventing the over-recognition of revenue (i.e., the standard focuses on potential significant reversals of revenue):

Extract from IFRS 15

56. An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

57. In assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:

(a) the amount of consideration is highly susceptible to factors outside the entity's influence. Those factors may include volatility in a market, the judgement or actions of third parties, weather conditions and a high 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 period of time.

(c) the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value.

(d) the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.

(e) the contract has a large number and broad range of possible consideration amounts.

[185] IFRS 15.BC203.
[186] IFRS 15.BC204.

To include variable consideration in the estimated transaction price, the entity has to conclude that it is 'highly probable' that a significant revenue reversal will not occur in future periods once the uncertainty related to the variable consideration is resolved. For the purpose of this analysis, the meaning of the term 'highly probable' is consistent with the existing definition in IFRS, i.e., "significantly more likely than probable".[187]

FASB differences

For US GAAP preparers, ASC 606 uses the term 'probable' as the confidence threshold for applying the constraint, rather than 'highly probable', which is defined as "the future event or events are likely to occur."[188] However, the meaning of 'probable' under US GAAP is intended to be the same as 'highly probable' under IFRS.[189]

Furthermore, the IASB noted that an entity's analysis to determine whether its estimate of variable consideration should be constrained is largely qualitative.[190] That is, an entity needs to use judgement to evaluate whether it has met the objective of the constraint (i.e., it is highly probable that a significant revenue reversal will not occur in future periods) considering the factors provided in the standard that increase the probability of a significant revenue reversal (discussed further below). In addition, conclusions about amounts that may result in a significant revenue reversal may change as an entity satisfies a performance obligation.

An entity needs to consider both the likelihood and magnitude of a revenue reversal to apply the constraint:

- *Likelihood* – assessing the likelihood of a future reversal of revenue requires significant judgement. Entities want to ensure they adequately document the basis for their conclusions. The presence of any one of the indicators cited in the extract above does not necessarily mean that a reversal will occur if the variable consideration is included in the transaction price. The standard includes factors, rather than criteria, to signal that the list of items to consider is not a checklist for which all items need to be met. In addition, the factors provided are not meant to be an all-inclusive list and entities may consider additional factors that are relevant to their facts and circumstances.
- *Magnitude* — when assessing the probability of a significant revenue reversal, an entity is also required to assess the magnitude of that reversal. The constraint is based on the probability of a reversal of an amount that is 'significant' relative to the cumulative revenue recognised for the contract. When assessing the significance of the potential revenue reversal, the cumulative revenue recognised at the date of the potential reversal includes both fixed and variable consideration and includes revenue recognised from the entire contract, not just the transaction price allocated to a single performance obligation.

[187] As defined in IFRS 5 Appendix A.
[188] For US GAAP, the term 'probable' is defined in the master glossary of the US Accounting Standards Codification as "the future event or events are likely to occur".
[189] IFRS15.BC211.
[190] IFRS15.BC212.

An entity must carefully evaluate the factors that could increase the likelihood or the magnitude of a revenue reversal, including those listed in IFRS 15.57:

- The amount of consideration is highly susceptible to factors outside the entity's influence (e.g., volatility in a market, judgement or actions of third parties, weather conditions, high risk of obsolescence of the promised good or service).
- The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- The entity's experience (or other evidence) of similar types of contracts is limited, or that experience (or other evidence) has limited predictive value.
- The entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.
- The contract has a large number and broad range of possible consideration amounts.

Illustration 5-3 — Evaluating the factors that could increase the likelihood or magnitude of a significant revenue reversal

Assume that an insurance broker receives 'trailing commissions' of CU100 every time a consumer signs up for a new insurance policy and CU50 whenever one of those consumers renews a policy.

In this fact pattern, the broker has a large pool of historical data about customer renewal patterns, given its significant experience with similar contracts. The broker considers the above factors and notes that the amount of consideration is highly susceptible to factors outside its influence and the uncertainty could remain over several years. However, it also has significant experience with similar types of contracts and its experience has predictive value.

As a result, even though the amount of consideration the entity will be entitled to is uncertain and depends on the actions of third parties (i.e., customer renewals), it is likely that the entity can estimate a minimum amount of variable consideration for which it is highly probable that a significant reversal of cumulative revenue will not occur. Assuming the broker's performance is complete upon initial signing of a contract, the broker would recognise the initial CU100 fee plus the minimum amount related to future renewals that is not constrained.

There are some types of variable consideration that are frequently included in contracts that have significant uncertainties. It is likely more difficult for an entity to assert it is highly probable that these types of estimated amounts will not be subsequently reversed. Examples of the types of variable consideration include the following:

- Payments contingent on regulatory approval (e.g., regulatory approval of a new drug)
- Long-term commodity supply arrangements that settle based on market prices at the future delivery date
- Contingency fees based on litigation or regulatory outcomes (e.g., fees based on the positive outcome of litigation or the settlement of claims with government agencies)

When an entity determines that it cannot meet the highly probable threshold if it includes all of the variable consideration in the transaction price, the amount of variable consideration that must be included in the transaction price is limited to the amount that would not result in a significant revenue reversal. That is, the estimate of variable consideration is reduced until it reaches an amount that can be included in the transaction price that, if subsequently reversed when the uncertainty associated with the variable consideration is resolved, would not result in a significant reversal of cumulative revenue recognised. When there is significant uncertainty about the ultimate pricing of a contract, entities should not default to constraining the estimate of variable consideration to zero.

The standard includes an example in which the application of the constraint limits the amount of variable consideration included in the transaction price and one in which it does not:

Extract from IFRS 15

Example 23 — Price concessions (IFRS 15.IE116-IE123)

An entity enters into a contract with a customer, a distributor, on 1 December 20X7. The entity transfers 1,000 products at contract inception for a price stated in the contract of CU100 per product (total consideration is CU100,000). Payment from the customer is due when the customer sells the products to the end customers. The entity's customer generally sells the products within 90 days of obtaining them. Control of the products transfers to the customer on 1 December 20X7.

On the basis of its past practices and to maintain its relationship with the customer, the entity anticipates granting a price concession to its customer because this will enable the customer to discount the product and thereby move the product through the distribution chain. Consequently, the consideration in the contract is variable.

Case A—Estimate of variable consideration is not constrained

The entity has significant experience selling this and similar products. The observable data indicate that historically the entity grants a price concession of approximately 20 per cent of the sales price for these products. Current market information suggests that a 20 per cent reduction in price will be sufficient to move the products through the distribution chain. The entity has not granted a price concession significantly greater than 20 per cent in many years.

To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see paragraph 53(a) of IFRS 15) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates the transaction price to be CU80,000 (CU80 × 1,000 products).

The entity also considers the requirements in paragraphs 56-58 of IFRS 15 on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of CU80,000 can be included in the transaction price. The entity considers the factors in paragraph 57 of IFRS 15 and determines that it has significant previous experience with this product and current market information that supports its estimate. In addition, despite some uncertainty resulting from factors outside its influence, based on its current market estimates, the entity expects the price to be resolved within a short time frame. Thus, the entity concludes that it

Extract from IFRS 15 (cont'd)

is highly probable that a significant reversal in the cumulative amount of revenue recognised (ie CU80,000) will not occur when the uncertainty is resolved (ie when the total amount of price concessions is determined). Consequently, the entity recognises CU80,000 as revenue when the products are transferred on 1 December 20X7.

Case B—Estimate of variable consideration is constrained

The entity has experience selling similar products. However, the entity's products have a high risk of obsolescence and the entity is experiencing high volatility in the pricing of its products. The observable data indicate that historically the entity grants a broad range of price concessions ranging from 20–60 per cent of the sales price for similar products. Current market information also suggests that a 15–50 per cent reduction in price may be necessary to move the products through the distribution chain.

To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see paragraph 53(a) of IFRS 15) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that a discount of 40 per cent will be provided and, therefore, the estimate of the variable consideration is CU60,000 (CU60 × 1,000 products).

The entity also considers the requirements in paragraphs 56–58 of IFRS 15 on constraining estimates of variable consideration to determine whether some or all of the estimated amount of variable consideration of CU60,000 can be included in the transaction price. The entity considers the factors in paragraph 57 of IFRS 15 and observes that the amount of consideration is highly susceptible to factors outside the entity's influence (ie risk of obsolescence) and it is likely that the entity may be required to provide a broad range of price concessions to move the products through the distribution chain. Consequently, the entity cannot include its estimate of CU60,000 (ie a discount of 40 per cent) in the transaction price because it cannot conclude that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. Although the entity's historical price concessions have ranged from 20–60 per cent, market information currently suggests that a price concession of 15–50 per cent will be necessary. The entity's actual results have been consistent with then-current market information in previous, similar transactions.

Consequently, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised will not occur if the entity includes CU50,000 in the transaction price (CU100 sales price and a 50 per cent price concession) and therefore, recognises revenue at that amount. Therefore, the entity recognises revenue of CU50,000 when the products are transferred and reassesses the estimates of the transaction price at each reporting date until the uncertainty is resolved in accordance with paragraph 59 of IFRS 15.

In some situations, it is appropriate for an entity to include in the transaction price an estimate of variable consideration that is not a possible outcome of an individual contract. The TRG discussed this topic using the following example from the TRG agenda paper:[191]

Example of estimating variable consideration using the expected value method

Entity A develops websites for customers. The contracts include similar terms and conditions and contain a fixed fee, plus variable consideration for a performance bonus related to the timing of Entity A completing the website. Based on Entity A's historical experience, the bonus amounts and associated probabilities for achieving each bonus are, as follows:

Bonus amount	Probability of outcome
-	15%
CU50	40%
CU100	45%

Entity A determines that using the expected value method would better predict the amount of consideration to which it will be entitled than using the most likely amount method because it has a large number of contracts that have characteristics that are similar to the new contract.

Under the expected value method, Entity A estimates variable consideration of CU65,000 [(0 x 15%) + (50,000 x 40%) + (100,000 x 45%)]. Entity A must then consider the effect of applying the constraint on variable consideration. To do this, Entity A considers the factors that could increase the likelihood of a revenue reversal in IFRS 15.57 and concludes that it has relevant historical experience with similar types of contracts and that the amount of consideration is not highly susceptible to factors outside of its influence.

In determining whether the entity would include CU50,000 or CU65,000 in the transaction price, TRG members generally agreed that when an entity has concluded that the expected value approach is the appropriate method to estimate variable consideration, the constraint is also applied based on the expected value method. That is, the entity is not required to switch from an expected value method to a most likely amount for purposes of applying the constraint. As a result, if an entity applies the expected value method for a particular contract, the estimated transaction price may not be a possible outcome in an individual contract. Therefore, the entity could conclude that, in this example, CU65,000 is the appropriate estimate of variable consideration to include in the transaction price. It is important to note that in this example, the entity had concluded that none of the factors in IFRS 15.57 or any other factors indicate a likelihood of a significant revenue reversal.

When an entity uses the expected value method and determines that the estimated amount of variable consideration is not a possible outcome in the individual contract, the entity must still consider the constraint on variable consideration. Depending on the facts and circumstances of each contract, an entity may need to constrain its estimate of variable consideration, even though it has used an expected value method, if the factors in IFRS 15.57 indicate a likelihood of a significant revenue reversal. However, using the expected value method and considering probability-weighted amounts sometimes achieves the objective of the constraint on variable consideration.

[191] TRG Agenda paper no. 38, *Portfolio Practical Expedient and Application of Variable Consideration Constraint*, dated 13 July 2015.

When an entity estimates the transaction price using the expected value method, the entity reduces the probability of a revenue reversal because the estimate does not include all of the potential consideration due to the probability weighting of the outcomes. In some cases, the entity may not need to constrain the estimate of variable consideration if the factors in IFRS 15.57 do not indicate a likelihood of a significant revenue reversal.

Example 25 in the standard illustrates a situation in which a qualitative analysis of the factors in IFRS 15.57 indicates that it is not highly probable that a significant reversal would not occur if an entity includes a performance-based incentive fee in the transaction price of an investment management contract.

See section 6 for a discussion of allocating the transaction price.

How we see it

Applying the constraint is an integral part of the evaluation of the variable consideration and it applies to all types of variable consideration that must be estimated in all transactions.

Frequently asked questions

Question 5-10: Is the constraint on variable consideration applied at the contract or performance obligation level? [TRG meeting 26 January 2015 – Agenda paper no. 14]

TRG members generally agreed that the constraint would be applied at the contract level and not at the performance obligation level. That is, the significance assessment of the potential revenue reversal would consider the total transaction price of the contract (and not the portion of transaction price allocated to a performance obligation).

Question 5-11: Would an entity be required to follow a two-step approach to estimate variable consideration (i.e., first estimate the variable consideration and then apply the constraint to that estimate)?

No. The Board noted in the Basis for Conclusions that an entity is not required to strictly follow a two-step process (i.e., first estimate the variable consideration and then apply the constraint to that estimate) if its internal processes incorporate the principles of both steps in a single step.[192] For example, if an entity already has a single process to estimate expected returns when calculating revenue from the sale of goods in a manner consistent with the objectives of applying the constraint, the entity would not need to estimate the transaction price and then separately apply the constraint.

A TRG agenda paper also noted that applying the expected value method, which requires an entity to consider probability-weighted amounts, may sometimes achieve the objective of the constraint on variable consideration.[193] That is, in developing its estimate of the transaction price in accordance with the expected value method, an entity reduces the probability of a revenue reversal and may not need to further constrain its estimate of variable consideration. However, to meet the objective of the constraint, the entity's estimated transaction price would need to incorporate

[192] IFRS 15.BC215.
[193] TRG Agenda paper no. 38, *Portfolio Practical Expedient and Application of Variable Consideration Constraint*, dated 13 July 2015.

Frequently asked questions (cont'd)

its expectations of the possible consideration amounts (e.g., products not expected to be returned) at a level at which it is highly probable that including the estimate of variable consideration in the transaction price would not result in a significant revenue reversal (e.g., such that it is highly probable that additional returns above the estimated amount would not result in a significant reversal).

Question 5-12: How does an entity apply the constraint on variable consideration to milestone payments?

An entity may need to apply significant judgement to determine whether and, if so, how much of a milestone payment is constrained. Assuming the payment is not subject to the sales-based or usage-based royalty recognition constraint (see section 8.5), a milestone payment is a form of variable consideration that needs to be estimated and included in the transaction price, subject to the variable consideration constraint.

Milestone payments are often binary (i.e., the entity will either achieve the target or desired outcome and become entitled to the milestone payment or not). In these situations, entities generally conclude that the most likely amount method is the better predictor of the amount to which it expects to be entitled. The entity will then consider the constraint on variable consideration to determine whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainties related to the milestone payments have been resolved. When assessing the significance of the potential revenue reversal of a future milestone payment, the cumulative revenue recognised at the date of the potential reversal would include any fixed consideration in addition to the variable consideration for the entire contract.

Applying the constraint to milestone payments often requires significant judgement, especially when uncertainty exists about the underlying activities necessary to meet the target or desired outcome that entitle the entity to the milestone payment. Entities need to analyse the facts and circumstances of each milestone payment and consider all information (historical, current and forecast) that is reasonably available to them to assess whether the revenue needs to be constrained. In addition, there could be external factors that affect an entity's assessment of the contract and the probability of entitlement to milestone payments. For example, we expect entities to conclude in many instances that milestone payments contingent on regulatory approval (e.g., regulatory approval of a new drug) are constrained, preventing them from recognising these payments until the uncertainty associated with the payments is resolved.

Consider the following example:

Illustration 5-4 — Milestone payments

Biotech enters into an arrangement with Pharma under which Biotech provides a licence to a product candidate that is starting phase II clinical studies and performs research and development services for a specified period of time. Assume that these two promises are determined to be distinct. Biotech receives an upfront payment upon execution of the arrangement and may receive milestone payments upon: (1) enrolment of a specified number of patients in a phase II clinical study; (2) completion of phase III clinical studies, (3) regulatory approval in the US; and (4) regulatory approval in the European Union.

Frequently asked questions (cont'd)

Illustration 5-4 — Milestone payments (cont'd)

Under the standard, Biotech includes in the transaction price the upfront payment and its estimate of the milestone payments it expects to receive. The amount of consideration that Biotech can include in the transaction price is limited to amounts for which it is highly probable that a significant reversal of cumulative revenues recognised under the contract will not occur in future periods.

The milestone for patient enrolment only has two possible outcomes (e.g., Biotech enrols or does not enrol the specified number of patients). Therefore, Biotech determines that the most likely amount method is the better predictor of the milestone payment. It then determines that it can include the amount associated with the enrolment milestone in the transaction price because it is highly probable that doing so will not result in a significant revenue reversal, based on: its prior experience with enrolling participants in similar studies; clinical trial results on the product candidate to date; and the significance of the milestone payment compared to the cumulative revenues expected to be recognised under the contract at the time of the enrolment milestone.

Due to the significant uncertainty associated with the other future events that would result in milestone payments, however, Biotech initially determines that it cannot include these amounts in the transaction price (i.e., the other milestone payments are fully constrained at contract inception). At the end of each reporting period, Biotech updates its assessment of whether the milestone payments are constrained by considering both the likelihood and magnitude of a potential revenue reversal.

The evaluation of the constraint considers the probability of reversal (i.e., not achieving the target or desired outcome) and whether any such reversal would be significant in relation to cumulative revenue recognised to date on the total contract. There are many variables that need to be factored into this assessment. Thus, entities should carefully evaluate each milestone to determine when it is appropriate to include the milestone in the transaction price.

For example, an entity may consider the variable consideration constraint and conclude that the milestone payment is not constrained at contract inception because including the milestone payment in the transaction price would not result in a significant reversal of cumulative revenue in the event that the milestone requirements are not achieved (i.e., the entity is not entitled to the consideration). This may be the case when an entity expects to recognise a significant amount of the contract revenue early in the life of the contract and the milestone payment amount is not significant in relation to the cumulative revenue that will be recognised by the time the uncertainties related to the milestone have been resolved.

As discussed in section 5.2.4, an entity is required to update its estimate of variable consideration (including any amounts that are constrained) at the end of each reporting period to reflect its revised expectations of the amount of consideration to which it expects to be entitled. For example, an entity may initially conclude that a milestone payment is constrained and, therefore, exclude it from the transaction price. However, in a later reporting period, when reassessing the amount of variable consideration that should be included in the transaction price, the entity may conclude a milestone

Frequently asked questions (cont'd)

payment is no longer constrained even though the target or desired outcome has not been achieved. That is, based on new information, an entity may conclude that it expects to achieve the target or desired outcome and, therefore, concludes that it is now highly probable that a significant revenue reversal will not occur.

5.2.4 Reassessment of variable consideration (updated October 2020)

When a contract includes variable consideration, an entity needs to update its estimate of the transaction price throughout the term of the contract to depict conditions that exist at the end of each reporting period. This involves updating the estimate of the variable consideration (including any amounts that are constrained) to reflect an entity's revised expectations about the amount of consideration to which it expects to be entitled, considering uncertainties that are resolved or new information that is gained about remaining uncertainties. As discussed in 5.2.3, conclusions about amounts that may result in a significant revenue reversal may change as an entity satisfies a performance obligation. See section 6.5 for a discussion of allocating changes in the transaction price after contract inception.

The IASB noted in the Basis for Conclusions that, in some cases, an estimate of variable consideration made at the end of an accounting period could be affected by information that arises after the end of the reporting period, but before the release of the financial statements. The Board decided not to include guidance in IFRS 15 on accounting in these situations, because it noted that the accounting for subsequent events is already addressed in IAS 10 *Events after the Reporting Period*.[194]

5.3 Refund liabilities

An entity may receive consideration that it will need to refund to the customer in the future because the consideration is not an amount to which the entity ultimately will be entitled under the contract. If an entity expects to refund some or all of that consideration, the amounts received (or receivable) need to be recorded as refund liabilities.

A refund liability is measured at the amount the entity ultimately expects it will have to return to the customer and such amount is not included in the transaction price. An entity is required to update its estimates of refund liabilities (and the corresponding change in the transaction price) at the end of each reporting period.

While the most common form of refund liabilities may be related to sales with a right of return (see section 5.4), the refund liability requirements also apply when an entity expects that it will need to refund consideration received due to poor customer satisfaction with a service provided (i.e., there was no good delivered or returned) and/or if an entity expects to have to provide retrospective price reductions to a customer (e.g., if a customer reaches a certain threshold of purchases, the unit price is retrospectively adjusted).

Frequently asked questions

Question 5-13: Is a refund liability a contract liability (and, thus, subject to the presentation and disclosure requirements of a contract liability)?

See response to Question 10-4 in section 10.1.

[194] IFRS 15.BC228.

5.4 Rights of return (updated September 2019)

The standard notes that, in some contracts, an entity may transfer control of a product to a customer, but grant the customer a right of return. In return, the customer may receive a full or partial refund of any consideration paid; a credit that can be applied against amounts owed, or that will be owed, to the entity; another product in exchange; or any combination thereof.[195] As discussed in section 4.7, the standard states that a right of return does not represent a separate performance obligation. Instead, a right of return affects the transaction price and the amount of revenue an entity can recognise for satisfied performance obligations. In other words, rights of return create variability in the transaction price.

Under IFRS 15, rights of return do not include exchanges by customers of one product for another of the same type, quality, condition and price (e.g., one colour or size for another). Nor do rights of return include situations where a customer may return a defective product in exchange for a functioning product; these are, instead, evaluated in accordance with the application guidance on warranties (see section 9.1).

The standard provides the following application guidance to determine how rights of return would be treated:

Extract from IFRS 15

B21. To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognise all of the following:

(a) revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned);

(b) a refund liability; and

(c) an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.

Under the standard, an entity estimates the transaction price and applies the constraint to the estimated transaction price to determine the amount of consideration to which the entity expects to be entitled. In doing so, it considers the products expected to be returned in order to determine the amount to which the entity expects to be entitled (excluding consideration for the products expected to be returned). The entity recognises revenue based on the amount to which it expects to be entitled through to the end of the return period (considering expected product returns). An entity does not recognise the portion of the revenue subject to the constraint until the amount is no longer constrained, which could be at the end of the return period. The entity recognises the amount received or receivable that is expected to be returned as a refund liability, representing its obligation to return the customer's consideration (see section 5.3). Subsequently, at the end of each reporting period, the entity updates its assessment of amounts for which it expects to be entitled.

As part of updating its estimate, an entity must update its assessment of expected returns and the related refund liabilities. This remeasurement is performed at the end of each reporting period and reflects any changes in assumptions about expected returns. Any adjustments made to the estimate result in a corresponding adjustment to amounts recognised as revenue for

[195] IFRS 15.B20.

the satisfied performance obligations (e.g., if the entity expects the number of returns to be lower than originally estimated, it would have to increase the amount of revenue recognised and decrease the refund liability).

Finally, when customers exercise their rights of return, the entity may receive the returned product in a saleable or repairable condition. Under the standard, at the time of the initial sale (i.e., when recognition of revenue is deferred due to the anticipated return), the entity recognises a return asset (and adjusts the cost of goods sold) for its right to recover the goods returned by the customer. The entity initially measures this asset at the former carrying amount of the inventory, less any expected costs to recover the goods, including any potential decreases in the value of the returned goods. The consideration of potential decreases in value of the returned products is important because the returned products may not be in the same condition they were in when they were sold (e.g., due to damage or use) and this helps to ensure that the value of the return asset is not impaired.

Along with remeasuring the refund liability at the end of each reporting period (as discussed above), the entity updates the measurement of the asset recorded for any revisions to its expected level of returns, as well as any additional potential decreases in the value of the returned products. Because the standard includes specific remeasurement requirements for the return asset, an entity applies those requirements, rather than other impairment models (e.g., inventory). The standard also requires the refund liability to be presented separately from the corresponding asset (i.e., on a gross basis, rather than a net basis).[196] While the standard does not explicitly state this, we believe that the return asset would generally be presented separately from inventory.

The standard provides the following example of rights of return:

Extract from IFRS 15

Example 22 — Right of return (IFRS 15.IE110-IE115)

An entity enters into 100 contracts with customers. Each contract includes the sale of one product for CU100 (100 total products × CU100 = CU10,000 total consideration). Cash is received when control of a product transfers. 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 entity's cost of each product is CU60.

The entity applies the requirements in IFRS 15 to the portfolio of 100 contracts because it reasonably expects that, in accordance with paragraph 4, the effects on the financial statements from applying these requirements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio.

Because the contract allows a customer to return the products, the consideration received from the customer is variable. To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see paragraph 53(a) of IFRS 15) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that 97 products will not be returned.

[196] IFRS 15.B25.

Extract from IFRS 15 (cont'd)

The entity also considers the requirements in paragraphs 56–58 of IFRS 15 on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of CU9,700 (CU100 × 97 products not expected to be returned) can be included in the transaction price. The entity considers the factors in paragraph 57 of IFRS 15 and determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame (ie the 30-day return period). Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (ie CU9,700) will not occur as the uncertainty is resolved (ie over the return period).

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 100 products, the entity does not recognise revenue for the three products that it expects to be returned. Consequently, in accordance with paragraphs 55 and B21 of IFRS 15, the entity recognises the following:

(a) revenue of CU9,700 (CU100 × 97 products not expected to be returned);

(b) a refund liability of CU300 (CU100 refund × 3 products expected to be returned); and

(c) an asset of CU180 (CU60 × 3 products for its right to recover products from customers on settling the refund liability).

In ASC 606, the same example includes the following journal entries to illustrate how the entity would account for the contract in Example 22 in accordance with the US GAAP equivalent of IFRS 15.55 and B21 when the product is transferred to the customer:[197]

Cash		CU10,000[(a)]	
	Revenue		CU9,700[(b)]
	Refund liability		CU300[(c)]
Cost of sales		CU 5,820[(d)]	
Asset		CU 180[(e)]	
	Inventory		CU 6,000[(f)]

(a) (CU100 × 100 products transferred).

(b) (CU100 × 97 products not expected to be returned)

(c) (CU100 refund × 3 products expected to be returned)

(d) (CU60 × 97 products not expected to be returned)

(e) (CU60 × 3 products for its right to recover products from customers on settling the refund liability)

(f) (CU60 × 100 products)

[197] ASC 606-10-55-207.

Frequently asked questions

Question 5-14: Is an entity applying the portfolio approach practical expedient when accounting for rights of return? [TRG meeting 13 July 2015 – Agenda paper no. 38]

An entity can, but would not be required to, apply the portfolio approach practical expedient to estimate variable consideration for expected returns using the expected value method. Similar to the discussion in section 5.2.2 on estimating variable consideration, the TRG agenda paper noted that an entity can consider evidence from other, similar contracts to develop an estimate of variable consideration using the expected value method without applying the portfolio approach practical expedient. In order to estimate variable consideration in a contract, an entity frequently makes judgements considering its historical experience with other, similar contracts. Considering historical experience does not necessarily mean the entity is applying the portfolio approach practical expedient.

This question arises, in part, because Example 22 from the standard (in the extract above) states that the entity is using the portfolio approach practical expedient in IFRS 15.4 to calculate its estimate of returns. Use of this practical expedient requires an entity to assert that it does not expect the use of the expedient to differ materially from applying the standard to an individual contract.

We expect that entities often use the expected value method to estimate variable consideration related to returns because doing so would likely better predict the amount of consideration to which the entities will be entitled. This is despite the fact that there are two potential outcomes for each contract from the variability of product returns: the product either will be returned or will not be returned. That is, the revenue for each contract ultimately either will be 100% or will be 0% of the total contract value (assuming returns create the only variability in the contract). However, entities may conclude that the expected value is the appropriate method for estimating variable consideration because they have a large number of contracts with similar characteristics. The TRG agenda paper noted that using a portfolio of data is not equivalent to using the portfolio approach practical expedient, so entities that use the expected value method to estimate variable consideration for returns would not be required to assert that the outcome from the portfolio is not expected to materially differ from an assessment of individual contracts.

Frequently asked questions (cont'd)

Question 5-15: How should an entity account for restocking fees for goods that are expected to be returned? [TRG meeting 13 July 2015 – Agenda paper no. 35]

Entities sometimes charge customers a 'restocking fee' when a product is returned. This fee may be levied by entities to compensate them for the costs of repackaging, shipping and/or reselling the item at a lower price to another customer. Stakeholders had raised questions about how to account for restocking fees and related costs.

TRG members generally agreed that restocking fees for goods that are expected to be returned would be included in the estimate of the transaction price at contract inception and recorded as revenue when (or as) control of the good transfers. That is, selling a product subject to a restocking fee if it is returned is not different from providing a partial return right and should be accounted for similarly.

Consider the following example in the TRG agenda paper:

Example of restocking fees

Entity A enters into a contract with a customer to sell 10 widgets for CU100 each. The customer has the right to return the widgets, but, if it does so, it will be charged a 10% restocking fee (or CU10 per returned widget). The entity estimates that 10% of all widgets that are sold will be returned. Upon transfer of control of the 10 widgets, the entity will recognise revenue of CU910 [(9 widgets not expected to be returned x CU100 selling price) + (1 widget expected to be returned x CU10 restocking fee)]. A refund liability of CU90 will also be recorded [1 widget expected to be returned x (CU100 selling price - CU10 restocking fee)].

Question 5-16: How should an entity account for restocking costs related to expected returns (e.g., shipping or repackaging costs)? [TRG meeting 13 July 2015 – Agenda paper no. 35]

TRG members generally agreed that restocking costs (e.g., shipping and repackaging costs) would be recorded as a reduction of the amount of the return asset when (or as) control of the good is transferred to the customer. This accounting treatment is consistent with the requirement in IFRS 15.B25 that the return asset be initially measured at the former carrying amount of the inventory, less any expected costs to recover the goods (e.g., restocking costs).

Question 5-17: How can an entity evaluate a conditional call option to repurchase an asset?

See response to Question 7-21 in section 7.3.1.

5.5 Significant financing component (updated October 2020)

For some transactions, the receipt of the consideration does not match the timing of the transfer of goods or services to the customer (e.g., the consideration is prepaid or is paid after the services are provided). When the customer pays in arrears, the entity is effectively providing financing to the customer. Conversely, when the customer pays in advance, the entity has effectively received financing from the customer.

IFRS 15 states the following in relation to a significant financing component in a contract:

Extract from IFRS 15

60. In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

61. The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (ie the cash selling price). An entity shall consider all relevant facts and circumstances in assessing whether a contract contains a financing component and whether that financing component is significant to the contract, including both of the following:

(a) the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services; and

(b) the combined effect of both of the following:

  (i) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and

  (ii) the prevailing interest rates in the relevant market.

62. Notwithstanding the assessment in paragraph 61, a contract with a customer would not have a significant financing component if any of the following factors exist:

(a) the customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer.

(b) a substantial amount of the consideration promised by the customer is variable and the amount or timing of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the entity (for example, if the consideration is a sales-based royalty).

Extract from IFRS 15 (cont'd)

(c) the difference between the promised consideration and the cash selling price of the good or service (as described in paragraph 61) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

63. As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

64. To meet the objective in paragraph 61 when adjusting the promised amount of consideration for a significant financing component, an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract, as well as any collateral or security provided by the customer or the entity, including assets 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 price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer. After contract inception, an entity shall not update the discount rate for changes in interest rates or other circumstances (such as a change in the assessment of the customer's credit risk).

The Board explained in the Basis for Conclusions that, conceptually, a contract that includes a financing component is comprised of two transactions — one for the sale of goods and/or services and one for the financing.[198] Accordingly, the Board decided to require entities to adjust the amount of promised consideration for the effects of financing only if the timing of payments specified in the contract provides the customer or the entity with a significant benefit of financing. The IASB's objective in requiring entities to adjust the promised amount of consideration for the effects of a significant financing component is for entities to recognise as revenue the 'cash selling price' of the underlying goods or services at the time of transfer.[199]

Practical expedient

As a practical expedient, an entity is not required to adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less. The Board added this practical expedient to the standard because it simplifies the application of this aspect of IFRS 15 and because the effect of accounting for a significant financing component (or of not doing so) should be limited in financing arrangements with a duration of less than 12 months.[200] If an entity uses this practical expedient, it would apply the expedient consistently to similar contracts in similar circumstances.[201]

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[198] IFRS 15.BC229.
[199] IFRS 15.BC230.
[200] IFRS 15.BC236.
[201] IFRS 15.BC235.

It is important to note that if the period between when the entity transfers a promised good or service to a customer and the customer pays for that good or service is more than one year and the financing component is deemed to be significant, the entity must account for the entire financing component. That is, an entity cannot exclude the first 12 months of the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service from the calculation of the potential adjustment to the transaction price. An entity also cannot exclude the first 12 months in its determination of whether the financing component of a contract is significant.

Entities may need to apply judgement to determine whether the practical expedient applies to some contracts. For example, the standard does not specify whether entities should assess the period between payment and performance at the contract level or at the performance obligation level. In addition, the TRG discussed how an entity should consider whether the practical expedient applies to contracts with a single payment stream for multiple performance obligations. See Question 5-21 below.

Existence of a significant financing component

Absent the use of the practical expedient, to determine whether a significant financing component exists, an entity needs to consider all relevant facts and circumstances, including:

(1) The difference between the cash selling price and the amount of promised consideration for the promised goods or services.

And

(2) The combined effect of the expected length of time between the transfer of the goods or services and the receipt of consideration and the prevailing market interest rates. The Board acknowledged that a difference in the timing between the transfer of and payment for goods or services is not determinative, but the combined effect of timing and the prevailing interest rates may provide a strong indication that an entity is providing or receiving a significant benefit of financing.[202]

Even if conditions in a contract would otherwise indicate that a significant financing component exists, the standard includes several situations that the Board has determined do not provide the customer or the entity with a significant benefit of financing. These situations, as described in IFRS 15.62, include the following:

- The customer has paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer. In these situations (e.g., prepaid phone cards, customer loyalty programmes), the Board noted in the Basis for Conclusions that the payment terms are not related to a financing arrangement between the parties and the costs of requiring an entity to account for a significant financing component would outweigh the benefits because an entity would need to continually estimate when the goods or services will transfer to the customer.[203]
- A substantial amount of the consideration promised by the customer is variable and is based on factors outside the control of the customer or entity. In these situations, the Board noted in the Basis for Conclusions that the primary purpose of the timing or terms of payment may be to allow for the resolution of uncertainties that relate to the consideration, rather

[202] IFRS 15.BC232.
[203] IFRS 15.BC233.

than to provide the customer or the entity with the significant benefit of financing. In addition, the terms or timing of payment in these situations may be to provide the parties with assurance of the value of the goods or services (e.g., an arrangement for which consideration is in the form of a sales-based royalty).[204]

- The difference between the promised consideration and the cash selling price of the good or service arises for reasons other than the provision of financing to either the customer or the entity (e.g., a payment is made in advance or in arrears in accordance with the typical payment terms of the industry or jurisdiction) and the difference between those amounts is proportional to the reason for the difference . In certain situations, the Board determined the purpose of the payment terms may be to provide the customer with assurance that the entity will complete its obligations under the contract, rather than to provide financing to the customer or the entity. Examples include a customer withholding a portion of the consideration until the contract is complete (illustrated in Example 27 below) or a milestone is reached, or an entity requiring a customer to pay a portion of the consideration upfront in order to secure a future supply of goods or services. See Question 5-18 for further discussion.

Advance payments

As explained in the Basis for Conclusions, the Board decided not to provide an overall exemption from accounting for the effects of a significant financing component arising from advance payments. This is because ignoring the effects of advance payments may skew the amount and timing of revenue recognised if the advance payment is significant and the purpose of the payment is to provide the entity with financing.[205] For example, an entity may require a customer to make advance payments to avoid obtaining the financing from a third party. If the entity obtained third-party financing, it would likely charge the customer additional amounts to cover the finance costs incurred. The Board decided that an entity's revenue should be consistent regardless of whether it receives the significant financing benefit from a customer or from a third party because, in either scenario, the entity's performance is the same.

In order to conclude that an advance payment does not represent a significant financing component, we believe that an entity needs to support why the advance payment does not provide a significant financing benefit and describe its substantive business purpose.[206] As a result, it is important that entities analyse all of the relevant facts and circumstances. In a 2018 speech, a member of the SEC staff discussed a consultation with the Office of the Chief Accountant (OCA) in which a registrant concluded that a contract with a large upfront payment did not have a significant financing component because: (1) the upfront payment was made for reasons other than to provide a significant financing benefit; and (2) the difference between the upfront payment and what the customer would have paid, had the payments been made over the term of the arrangement, was proportional to the reason identified for the difference. The SEC staff member noted that, like other consultations that OCA has evaluated in relation to the revenue standard, the evaluation was based on the facts and circumstances. In this fact pattern, the staff did not object to the registrant's conclusion that the contract did not have a significant

[204] IFRS 15.BC233.
[205] IFRS 15.BC238.
[206] Consistent with the discussions within TRG Agenda paper no. 30, *Significant Financing Components*, dated 30 March 2015.

financing component based on the nature of the transaction and the purpose of the upfront payment.[207]

Example 29 below illustrates an entity's determination that a customer's advance payment represents a significant financing component. Example 30 illustrates an entity's determination that a customer's advance payment does not represent a significant financing component.

Assessment of significance

The assessment of significance is made at the individual contract level. As noted in the Basis for Conclusions, the Board decided that it would be an undue burden to require an entity to account for a financing component if the effects of the financing component are not significant to the individual contract, but the combined effects of the financing components for a portfolio of similar contracts would be material to the entity as a whole.[208]

Determination of the discount rate

When an entity concludes that a financing component is significant to a contract, in accordance with IFRS 15.64, it determines the transaction price by applying a discount rate to the amount of promised consideration. As stated above, the objective of requiring entities to adjust the promised consideration for the effects of a significant financing component is for the revenue recognised to approximate an amount that reflects the cash selling price that a customer would have paid for the promised goods or services. However, to achieve this objective, the entity does not need to estimate that cash selling price. Rather, the entity determines an interest rate and applies it to the amount of the promised consideration.

The entity uses the same interest rate that it would use if it were to enter into a separate financing transaction with the customer at contract inception. The interest rate needs to reflect the credit characteristics of the borrower in the contract, which could be either the entity or the customer (depending on who receives the financing). Using the risk-free rate or a rate explicitly stated in the contract that does not correspond with a separate financing rate would not be acceptable.[209] Example 28, Case B (shown below) illustrates a contractual discount rate that does not reflect the rate in a separate financing transaction. Furthermore, using a contract's implicit interest rate (i.e., the interest rate that would make alternative payment options economically equivalent) would also not be acceptable if that rate does not reflect the rate in a separate financing transaction (as illustrated in Example 29, included in section 5.5.1 below).

While not explicitly stated in the standard, we believe an entity would consider the expected term of the financing when determining the interest rate in light of current market conditions at contract inception. In addition, IFRS 15.64 is clear that an entity does not update the interest rate for changes in circumstances or market interest rates after contract inception.

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[207] Speech by Sarah N. Esquivel, Associate Chief Accountant, SEC Office of the Chief Accountant, 10 December 2018, SEC.gov.

[208] IFRS 15.BC234.

[209] IFRS 15.BC239.

How we see it

The standard requires that the interest rate be a rate similar to one that the entity would have used in a separate financing transaction with the customer. Because most entities are not in the business of entering into free-standing financing arrangements with their customers, they may find it difficult to identify an appropriate rate. However, most entities perform some level of credit analysis before financing purchases for a customer, so they likely have some information about the customer's credit risk. For entities that have different pricing for products depending on the time of payment (e.g., cash discounts), the standard indicates that the appropriate interest rate, in some cases, could be determined by identifying the rate that discounts the nominal amount of the promised consideration to the cash sales price of the good or service.

Entities likely have to exercise significant judgement to determine whether a significant financing component exists when there is more than one year between the transfer of goods or services and the receipt of contract consideration. Entities should consider sufficiently documenting their analyses to support their conclusions.

5.5.1 Examples of significant financing components (updated September 2019)

The standard includes several examples to illustrate these concepts. Example 26 illustrates a contract that contains a significant financing component because the cash selling price at contract inception differs from the promised amount of consideration payable after delivery and there are no other factors present that would indicate that this difference arises for reasons other than financing. In this example, the implicit interest rate in the contract is determined to be commensurate with the rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception.

Extract from IFRS 15

Example 26 — Significant financing component and right of return (IFRS 15.IE135-IE140)

An entity sells a product to a customer for CU121 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The contract permits the customer to return the product within 90 days. The product is new and the entity has no relevant historical evidence of product returns or other available market evidence.

The cash selling price of the product is CU100, which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception. The entity's cost of the product is CU80.

Extract from IFRS 15 (cont'd)

The entity does not recognise revenue when control of the product transfers to the customer. This is because the existence of the right of return and the lack of relevant historical evidence means that the entity cannot conclude that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur in accordance with paragraphs 56–58 of IFRS 15. Consequently, revenue is recognised after three months when the right of return lapses.

The contract includes a significant financing component, in accordance with paragraphs 60–62 of IFRS 15. This is evident from the difference between the amount of promised consideration of CU121 and the cash selling price of CU100 at the date that the goods are transferred to the customer.

The contract includes an implicit interest rate of 10 per cent (ie the interest rate that over 24 months discounts the promised consideration of CU121 to the cash selling price of CU100). The entity evaluates the rate and concludes that it is commensurate with the rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. The following journal entries illustrate how the entity accounts for this contract in accordance with paragraphs B20–B27 of IFRS 15.

(a) When the product is transferred to the customer, in accordance with paragraph B21 of IFRS 15:

Asset for right to recover product to be returned	CU80[(a)]	
Inventory		CU80

(a) This example does not consider expected costs to recover the asset.

(b) During the three-month right of return period, no interest is recognised in accordance with paragraph 65 of IFRS 15 because no contract asset or receivable has been recognised.

(c) When the right of return lapses (the product is not returned):

Receivable	CU100[(a)]	
Revenue		CU100
Cost of sales	CU80	
Asset for product to be returned		CU80

(a) The receivable recognised would be measured in accordance with IFRS 9. This example assumes there is no material difference between the fair value of the receivable at contract inception and the fair value of the receivable when it is recognised at the time the right of return lapses. In addition, this example does not consider the impairment accounting for the receivable.

Until the entity receives the cash payment from the customer, interest revenue would be recognised in accordance with IFRS 9. In determining the effective interest rate in accordance with IFRS 9, the entity would consider the remaining contractual term.

Example 26 also illustrates the requirement in IFRS 15.65, which provides that interest income or interest expense is recognised only to the extent that a contract asset (or receivable) or a contract liability is recognised in accounting for a contract with a customer. See further discussion in section 5.5.2.

In Example 27, the difference between the promised consideration and the cash selling price of the good or service arises for reasons other than the provision of financing. In this example, the customer withholds a portion of each payment until the contract is complete in order to protect itself from the entity failing to complete its obligations under the contract, as follows:

Extract from IFRS 15

Example 27 — Withheld payments on a long-term contract (IFRS 15.IE141-IE142)

An entity enters into a contract for the construction of a building that includes scheduled milestone payments for the performance by the entity throughout the contract term of three years. The performance obligation will be satisfied over time and the milestone payments are scheduled to coincide with the entity's expected performance. The contract provides that a specified percentage of each milestone payment is to be withheld (ie retained) by the customer throughout the arrangement and paid to the entity only when the building is complete.

The entity concludes that the contract does not include a significant financing component. The milestone payments coincide with the entity's performance and the contract requires amounts to be retained for reasons other than the provision of finance in accordance with paragraph 62(c) of IFRS 15. The withholding of a specified percentage of each milestone payment is intended to protect the customer from the contractor failing to adequately complete its obligations under the contract.

Example 28 illustrates two situations. In one, a contractual discount rate reflects the rate in a separate financing transaction. In the other, it does not.

Extract from IFRS 15

Example 28 — Determining the discount rate (IFRS 15.IE143-IE147)

An entity enters into a contract with a customer to sell equipment. Control of the equipment transfers to the customer when the contract is signed. The price stated in the contract is CU1 million plus a five per cent contractual rate of interest, payable in 60 monthly instalments of CU18,871.

Case A—Contractual discount rate reflects the rate in a separate financing transaction

In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the five per cent contractual rate of interest reflects the rate that would be used in a separate financing transaction between the entity and its customer at contract inception (ie the contractual rate of interest of five per cent reflects the credit characteristics of the customer).

The market terms of the financing mean that the cash selling price of the equipment is CU1 million. This amount is recognised as revenue and as a loan receivable when control of the equipment transfers to the customer. The entity accounts for the receivable in accordance with IFRS 9.

Case B—Contractual discount rate does not reflect the rate in a separate financing transaction

In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the five per cent contractual rate of interest is significantly lower than the 12 per cent interest rate that would be used in a separate financing transaction between the entity and its customer at contract inception (ie the contractual rate of interest of five per cent does not reflect the credit characteristics of the customer). This suggests that the cash selling price is less than CU1 million.

In accordance with paragraph 64 of IFRS 15, the entity determines the transaction price by adjusting the promised amount of consideration to reflect the contractual payments using the 12 per cent interest rate that reflects the credit characteristics of the customer. Consequently, the entity determines that the transaction price is CU848,357 (60 monthly payments of CU18,871 discounted at 12 per cent). The entity recognises revenue and a loan receivable for that amount. The entity accounts for the loan receivable in accordance with IFRS 9.

Example 29 illustrates a contract with an advance payment from the customer that the entity concludes represents a significant benefit of financing. It also illustrates a situation in which the implicit interest rate does not reflect the interest rate that would be used in a separate financing transaction between the entity and its customer at contract inception, as follows:

Extract from IFRS 15

Example 29 — Advance payment and assessment of discount rate (IFRS 15.IE148-IE151)

An entity enters into a contract with a customer to sell an asset. Control of the asset will transfer to the customer in two years (ie the performance obligation will be satisfied at a point in time). The contract includes two alternative payment options: payment of CU5,000 in two years when the customer obtains control of the asset or payment of CU4,000 when the contract is signed. The customer elects to pay CU4,000 when the contract is signed.

The entity concludes that the contract contains a significant financing component because of the length of time between when the customer pays for the asset and when the entity transfers the asset to the customer, as well as the prevailing interest rates in the market.

The interest rate implicit in the transaction is 11.8 per cent, which is the interest rate necessary to make the two alternative payment options economically equivalent. However, the entity determines that, in accordance with paragraph 64 of IFRS 15, the rate to be used in adjusting the promised consideration is six per cent, which is the entity's incremental borrowing rate.

The following journal entries illustrate how the entity would account for the significant financing component:

(1) recognise a contract liability for the CU4,000 payment received at contract inception:

Cash	CU4,000	
Contract liability		CU4,000

(2) during the two years from contract inception until the transfer of the asset, the entity adjusts the promised amount of consideration (in accordance with paragraph 65 of IFRS 15) and accretes the contract liability by recognising interest on CU4,000 at six per cent for two years:

Interest expense	CU494[(a)]	
Contract liability		CU494

(a) CU494 = CU4,000 contract liability × (6 per cent interest per year for two years).

(3) recognise revenue for the transfer of the asset:

Contract liability	CU4,494	
Revenue		CU4,494

In Example 30, involving a contract with an advance payment from the customer, the entity determines that a significant financing component does not exist because the difference between the amount of promised consideration and the cash selling price of the good or service arises for reasons other than the provision of financing, as follows:

Extract from IFRS 15

Example 30 — Advance payment (IFRS 15.IE152-IE154)

An entity, a technology product manufacturer, enters into a contract with a customer to provide global telephone technology support and repair coverage for three years along with its technology product. The customer purchases this support service at the time of buying the product. Consideration for the service is an additional CU300. Customers electing to buy this service must pay for it upfront (ie a monthly payment option is not available).

To determine whether there is a significant financing component in the contract, the entity considers the nature of the service being offered and the purpose of the payment terms. The entity charges a single upfront amount, not with the primary purpose of obtaining financing from the customer but, instead, to maximise profitability, taking into consideration the risks associated with providing the service. Specifically, if customers could pay monthly, they would be less likely to renew and the population of customers that continue to use the support service in the later years may become smaller and less diverse over time (ie customers that choose to renew historically are those that make greater use of the service, thereby increasing the entity's costs). In addition, customers tend to use services more if they pay monthly rather than making an upfront payment. Finally, the entity would incur higher administration costs such as the costs related to administering renewals and collection of monthly payments.

In assessing the requirements in paragraph 62(c) of IFRS 15, the entity determines that the payment terms were structured primarily for reasons other than the provision of finance to the entity. The entity charges a single upfront amount for the services because other payment terms (such as a monthly payment plan) would affect the nature of the risks assumed by the entity to provide the service and may make it uneconomical to provide the service. As a result of its analysis, the entity concludes that there is not a significant financing component.

Frequently asked questions

Question 5-18: The standard states that a significant financing component does not exist if the difference between the promised consideration and the cash selling price of the good or service arises for reasons other than the provision of finance. How broadly would this factor be applied? [TRG meeting 30 March 2015 – Agenda paper no. 30]

According to IFRS 15, a significant financing component does not exist if the difference between the promised consideration and the cash selling price of the good or service arises for reasons other than the provision of finance.[210] TRG members discussed how broadly this factor would be applied.

TRG members generally agreed that there is likely significant judgement involved in determining whether either party is providing financing or the payment terms are for another reason. TRG members also generally agreed that the Board did not seem to intend to create a presumption that a significant financing component exists if the cash selling price differs from the promised consideration (or there is a long period of time between transfer of the goods and payment).

The TRG agenda paper noted that, although IFRS 15.61 states that the measurement objective for a significant financing component is to recognise revenue for the goods or services at an amount that reflects the cash selling price, this measurement objective is only followed when an entity has already determined that a significant financing component exists. The fact that there is a difference in the promised consideration and the cash selling price is not a principle for determining whether a significant financing component actually exists. It is only one factor to consider.

Many TRG members noted that it requires significant judgement in some circumstances to determine whether a transaction includes a significant financing component. TRG members also acknowledged that when entities consider whether the difference between the promised consideration and cash selling price is for a reason other than financing, they must consider whether the difference between those amounts is proportional to the reason for the difference, as contemplated in IFRS 15.62(c).

Question 5-19: If the promised consideration is equal to the cash selling price, does a financing component exist? [TRG meeting 30 March 2015 – Agenda paper no. 30]

TRG members generally agreed that even if the list price, cash selling price and promised consideration of a good or service are all equal, an entity should not automatically assume that a significant financing component does not exist. This would be a factor to consider, but it would not be determinative.

As discussed above in Question 5-18, while IFRS 15.61 states that the measurement objective for a significant financing component is to recognise revenue for the goods or services at an amount that reflects the cash selling price, this measurement objective is only followed when an entity has already determined that a significant financing component exists. The fact that there is no difference between the promised consideration and the cash selling price is not determinative in the evaluation of whether a significant financing component actually exists. It is a factor to consider, but it is not the only

[210] IFRS 15.62(c).

Frequently asked questions (cont'd)

factor and is not determinative. As discussed above, an entity needs to consider all facts and circumstances in this evaluation.

The TRG agenda paper noted that the list price may not always equal the cash selling price (i.e., the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer, as defined in IFRS 15.61). For example, if a customer offers to pay cash upfront when the entity is offering 'free' financing to customers, the customer that offers the upfront payment may be able to pay less than the list price. Determining a 'cash selling price' may require judgement and the fact that an entity provides 'interest-free financing' does not necessarily mean that the cash selling price is the same as the price another customer would pay over time. Entities would have to consider the cash selling price in comparison to the promised consideration in making the evaluation based on the overall facts and circumstances of the arrangement.

This notion is consistent with IFRS 15.77 on allocating the transaction price to performance obligations based on stand-alone selling prices (see section 6.1), which indicates that a contractually stated price or a list price for a good or service may be (but is not presumed to be) the stand-alone selling price of that good or service. The TRG agenda paper noted that it may be possible for a financing component to exist, but that it may not be significant. As discussed above in this section, entities need to apply judgement in determining whether the financing component is significant.

Question 5-20: Does the standard preclude accounting for financing components that are not significant? [TRG meeting 30 March 2015 – Agenda paper no. 30]

TRG members generally agreed that the standard does not preclude an entity from deciding to account for a financing component that is not significant. For example, an entity may have a portfolio of contracts in which there is a mix of significant and insignificant financing components. An entity could choose to account for all of the financing components as if they were significant in order to avoid having to apply different accounting methods to each.

An entity electing to apply the requirements for significant financing components to an insignificant financing component would need to be consistent in its application to all similar contracts with similar circumstances.

Frequently asked questions (cont'd)

Question 5-21: The standard includes a practical expedient that allows an entity not to assess a contract for a significant financing component if the period between the customer's payment and the entity's transfer of the goods or services is one year or less.[211] How should entities consider whether the practical expedient applies to contracts with a single payment stream for multiple performance obligations? [TRG meeting 30 March 2015 – Agenda paper no. 30]

TRG members generally agreed that entities either apply an approach of allocating any consideration received:

(1) To the earliest good or service delivered

Or

(2) Proportionately between the goods or services depending on the facts and circumstances

The TRG agenda paper on this topic provided an example of a telecommunications entity that enters into a two-year contract to provide a device at contract inception and related data services over 24 months in exchange for 24 equal monthly instalments.[212] Under approach (1) above, an entity would be allowed to apply the practical expedient because the period between transfer of the good or service and customer payment would be less than one year for both the device and the related services. This is because, in the example provided, the device would be 'paid off' after five months. Under approach (2) above, an entity would not be able to apply the practical expedient because the device would be deemed to be paid off over the full 24 months (i.e., greater than one year).

Approach (2) above may be appropriate in circumstances similar to the example in the TRG agenda paper, when the cash payment is not directly tied to the earliest good or service delivered in a contract. Approach (1) may be appropriate when the cash payment is directly tied to the earliest good or service delivered in a contract. However, TRG members noted it may be difficult to tie a cash payment directly to a good or service because cash is fungible. Accordingly, judgement is required based on the facts and circumstances.

Question 5-22: If a significant financing component exists in a contract, how does an entity calculate the adjustment to revenue? [TRG meeting 30 March 2015 – Agenda paper no. 30]

TRG members generally agreed that the standard does not contain requirements for how to calculate the adjustment to the transaction price due to a significant financing component. A financing component is recognised as interest expense (when the customer pays in advance) or interest income (when the customer pays in arrears). Entities need to consider requirements outside IFRS 15 to determine the appropriate accounting treatment (i.e., IFRS 9).

[211] IFRS 15.63.
[212] TRG Agenda paper no. 30, *Significant Financing Components*, dated 30 March 2015.

Frequently asked questions (cont'd)

Question 5-23: How should an entity allocate a significant financing component when there are multiple performance obligations in a contract? [TRG meeting 30 March 2015 – Agenda paper no. 30]

The standard is clear that, when determining the transaction price in Step 3 of the model, the effect of financing is excluded from the transaction price prior to the allocation of the transaction price to performance obligations (which occurs in Step 4). However, stakeholders had questioned whether an adjustment for a significant financing component could ever be attributed to only one or some of the performance obligations in the contract, rather than to all of the performance obligations in the contract. This is because the standard only includes examples in which there is a single performance obligation.

TRG members generally agreed that it may be reasonable for an entity to attribute a significant financing component to one or more, but not all, of the performance obligations in the contract. In doing so, the entity may analogise to the exceptions for allocating variable consideration and/or discounts to one or more (but not all) performance obligations, if specified criteria are met (see sections 6.3 and 6.4, respectively). However, attribution of a financing component to one (or some) of the performance obligations requires the use of judgement, especially because cash is fungible.

Question 5-24: Is an entity required to evaluate whether a customer option that provides a material right includes a significant financing component? If so, how would entities perform this evaluation? [TRG meeting 30 March 2015 – Agenda paper no. 32]

See response to Question 4-19 in section 4.6.

Question 5-25: Can an entity consider an interest expense arising from a customer contract with a significant financing component as borrowing costs eligible for capitalisation?

IAS 23 *Borrowing Costs* requires borrowing costs to be capitalised if they are directly attributable to the acquisition, construction or production of a qualifying asset (whether or not the funds have been borrowed specifically for that purpose).[213] IAS 23 and IFRS 15 do not specifically address whether interest expense arising from a customer contract with a significant financing component can be considered as borrowing costs eligible for capitalisation.

According to IAS 23, borrowing costs are "interest and other costs that an entity incurs in connection with the borrowing of funds."[214] Interest expense arising from customer contracts with a significant financing component might qualify as borrowing costs eligible for capitalisation if they are directly attributable to the acquisition, construction or production of a qualifying asset.

[213] IAS 23.8.
[214] IAS 23.5 and IAS 23.6.

Frequently asked questions (cont'd)

For most revenue transactions, it is likely that entities would be considering inventory when determining whether there is a qualifying asset. According to IAS 23, inventory can be a qualifying asset, but "... inventories that are manufactured, or otherwise produced, over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired are also not qualifying assets."[215] Significant judgement may be needed to determine whether inventories take a substantial period of time to manufacture or produce before being ready for their intended use or sale. However, it may be helpful for an entity to consider how it satisfies its performance obligations as part of this determination. In particular, entities should note that, if a performance obligation is satisfied over time, by definition, the customer obtains control of the good or service (and the entity derecognises any related inventory) as the entity performs. As discussed in Question 7-16 in section 7.1.4.C, its performance should not result in the creation of a material asset in the entity's accounts (e.g., work in progress).

It is also important to note that capitalisation of borrowing costs is not required by IAS 23 for inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis even if they meet the definition of a qualifying asset.[216]

In late 2018, the IFRS IC received a request about the capitalisation of borrowing costs in relation to assets being developed for sale for which revenue is recognised over time as control transfers to the customer as the asset is constructed.

At its March 2019 meeting, the IFRS IC noted that, when applying IAS 23 an entity assesses whether there is a qualifying asset (i.e., an asset that necessarily takes a substantial period of time to get ready for its intended use or sale). The request referred to real estate units, which may take a substantial period of time to construct. However, the IFRS IC concluded that:

- *For any sold units*: there is no qualifying asset. When any of the criteria in IFRS 15.35 are met (and revenue is recognised over time), control transfers to the customer as the entity performs. Therefore, the entity holds no inventory. Instead, it recognises a receivable or contract asset for its right to receive consideration in exchange for its performance to date. IAS 23 explicitly states that receivables are not a qualifying asset.[217] Like receivables, the intended use of a contract assets is to collect cash (or another asset), which is not a use for which it necessarily takes a substantial period of time to get ready. Therefore, the IFRS IC observed that contract assets are also not qualifying assets.
- *For any unsold units*: any inventory (work-in-progress) for unsold units under construction is not a qualifying asset if: (i) the entity intends to sell the part-completed units as soon as it finds suitable customers – this is because the units are already ready for sale in their part-completed state; and (ii) control of the part-completed units transfers to the customer on signing the contract (which is the case if revenue is recognised over time).[218]

[215] IAS 23.7.
[216] IAS 23.4(b).
[217] IAS 23.7.
[218] *IFRIC Update*, March 2019 , available on the IASB's website.

5.5.2 Financial statement presentation of financing component (updated October 2018)

As discussed above, when a significant financing component exists in a contract, the transaction price is adjusted so that the amount recognised as revenue is the 'cash selling price' of the underlying goods or services at the time of transfer. Essentially, a contract with a customer that has a significant financing component would be separated into a revenue component (for the notional cash sales price) and a loan component (for the effect of the deferred or advance payment terms).[219] Consequently, the accounting for accounts receivable arising from a contract that has a significant financing component should be comparable to the accounting for a loan with the same features.[220]

The amount allocated to the significant financing component would have to be presented separately from revenue recognised from contracts with customers. The financing component is recognised as interest expense (when the customer pays in advance) or interest income (when the customer pays in arrears). The interest income or expense is recognised over the financing period using the effective interest method described in IFRS 9. The standard notes that interest is only recognised to the extent that a contract asset, contract liability or receivable is recognised in accordance with IFRS 15.[221]

As discussed in section 10.1, a contract asset (or receivable) or contract liability is generated (and presented on the balance sheet) when either party to a contract performs, depending on the relationship between the entity's performance and the customer's payment. Example 26 in the standard (see section 5.5.1) illustrates a situation in which an entity transfers control of a good to a customer, but the customer is not required to pay for the good until two years after delivery. The contract includes a significant financing component. Furthermore, the customer has the right to return the good for 90 days. The product is new and the entity does not have historical evidence of returns activity. Therefore, the entity is not able to recognise revenue (or a contract asset or receivable) upon delivery because it cannot assert that it is highly probable that a significant revenue reversal will not occur (i.e., it cannot assert that it is highly probable that the product will not be returned). Accordingly, during the 90-day return period, the entity also cannot record interest income. However, as depicted in the example, once the return period lapses, the entity can record revenue and a receivable, as well as begin to recognise interest income.

The IASB noted in the Basis for Conclusions that an entity may present interest income as revenue only when interest income represents income from an entity's ordinary activities.[222]

Although there are two components within the transaction price when there is a significant financing component (i.e., the revenue component and the significant financing component), it is only in the case of deferred payment terms that there are two cash flow components. In that case, the revenue component cash flows should be classified as cash flows from operating activities, and the cash flows related to the significant financing component should be classified consistent with the entity's choice to present cash flows from interests received/paid in accordance with IAS 7.33 (i.e., as cash flows from operating or investing/financing activities). If the customer pays in advance, the sum of the cash amount and the accrued interest represent revenue, and thus there is only one cash flow component. Accordingly, the cash received should be classified as cash flows from operating activities.

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[219] IFRS 15.BC244.
[220] IFRS 15.BC244.
[221] IFRS 15.65.
[222] IFRS 15.BC247.

Impairment losses on receivables, with or without a significant financing component, are presented in line with the requirements of IAS 1 *Presentation of Financial Statements* and disclosed in accordance with IFRS 7 *Financial Instruments: Disclosures*. However, IFRS 15 makes it clear that such amounts are disclosed separately from impairment losses from other contracts.[223]

How we see it

We believe entities may need to expend additional effort to track impairment losses on assets arising from contracts that are within the scope of IFRS 15 separately from impairment losses on assets arising from other contracts. Entities need to ensure that they have the appropriate systems, internal controls, policies and procedures in place to collect and separately present this information.

5.6 Non-cash consideration

Customer consideration may be in the form of goods, services or other non-cash consideration (e.g., property, plant and equipment, a financial instrument). When an entity (i.e., the seller or vendor) receives, or expects to receive, non-cash consideration, the fair value of the non-cash consideration is included in the transaction price.

An entity likely applies the requirements of IFRS 13 *Fair Value Measurement* or IFRS 2 *Share-based Payment* when measuring the fair value of any non-cash consideration. If an entity cannot reasonably estimate the fair value of non-cash consideration, it measures the non-cash consideration indirectly by reference to the stand-alone selling price of the promised goods or services. Significant judgement and consideration of specific facts and circumstances may be required in such situations (e.g., advertising barter transactions, see section 5.6.2 for further discussion on barter transactions).

For contracts with both non-cash consideration and cash consideration, an entity needs to measure the fair value of the non-cash consideration and it looks to other requirements within IFRS 15 to account for the cash consideration. For example, for a contract in which an entity receives non-cash consideration and a sales-based royalty, the entity would measure the fair value of the non-cash consideration and refer to the requirements within the standard for the sales-based royalties.

The fair value of non-cash consideration may change both because of the form of consideration (e.g., a change in the price of a share an entity is entitled to receive from a customer) and for reasons other than the form of consideration (e.g., a change in the exercise price of a share option because of the entity's performance). Under IFRS 15, if an entity's entitlement to non-cash consideration promised by a customer is variable for reasons other than the form of consideration (i.e., there is uncertainty as to whether the entity receives the non-cash consideration if a future event occurs or does not occur), the entity considers the constraint on variable consideration.

In some transactions, a customer contributes goods or services, such as equipment or labour, to facilitate the fulfilment of the contract. If the entity obtains control of the contributed goods or services, it would consider them non-cash consideration and account for that consideration as described above. Assessing whether the entity obtains control of the contributed goods or services by the customer may require judgement.

[223] IFRS 15.113(b).

The Board also noted that any assets recognised as a result of non-cash consideration are accounted for in accordance with other relevant standards (e.g., IAS 16).

The standard provides the following example of a transaction for which non-cash consideration is received in exchange for services provided:

Extract from IFRS 15

Example 31 — Entitlement to non-cash consideration (IFRS 15.IE156-IE158)

An entity enters into a contract with a customer to provide a weekly service for one year. The contract is signed on 1 January 20X1 and work begins immediately. The entity concludes that the service is a single performance obligation in accordance with paragraph 22(b) of IFRS 15. This is because the entity is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress—that is, a time-based measure of progress).

In exchange for the service, the customer promises 100 shares of its common stock per week of service (a total of 5,200 shares for the contract). The terms in the contract require that the shares must be paid upon the successful completion of each week of service.

The entity measures its progress towards complete satisfaction of the performance obligation as each week of service is complete. To determine the transaction price (and the amount of revenue to be recognised), the entity measures the fair value of 100 shares that are received upon completion of each weekly service. The entity does not reflect any subsequent changes in the fair value of the shares received (or receivable) in revenue.

5.6.1 Non-cash consideration application considerations

Stakeholders raised questions about the date that should be used when measuring the fair value of non-cash consideration for inclusion within the transaction price. In addition, constituents noted that the variability of non-cash consideration could arise both from its form (e.g., shares) and for other reasons (e.g., performance factors that affect the amount of consideration to which the entity will be entitled). Consequently, they questioned how the constraint on variable consideration would be applied in such circumstances.

At the January 2015 TRG meeting, members of the TRG discussed these questions and agreed that, while the standard requires non-cash consideration (e.g., shares, advertising provided as consideration from a customer) to be measured at fair value, it is unclear when that fair value must be measured (i.e., the measurement date). Members of the TRG discussed three measurement date options: contract inception; when it is received; or when the related performance obligation is satisfied. Each view received support from some TRG members. Since IFRS 15 does not specify the measurement date, an entity needs to use its judgement to determine the most appropriate measurement date when measuring the fair value of non-cash consideration. However, in accordance with IFRS 15.126, information about the methods, inputs and assumptions used to measure non-cash consideration needs to be disclosed.[224]

IFRS 15 requires that the constraint on variable consideration be applied to non-cash consideration only if the variability is due to factors other than the form of consideration (i.e., variability arising for reasons other than changes in the price of the non-cash consideration). The constraint does not apply if the non-cash consideration varies because of its form (e.g., listed shares for which the share price changes). However, the standard does not address how the constraint would be applied when the non-cash consideration is variable due to both its form and other reasons. While some TRG members said the standard could be interpreted to require an entity to split the consideration based on the source of the variability, other TRG members highlighted that this approach would be overly complex and would not provide useful information.

[224] IFRS 15.BC254E.

FASB differences

The FASB's standard specifies that the fair value of non-cash consideration needs to be measured at contract inception when determining the transaction price. Any subsequent changes in the fair value of the non-cash consideration due to its form (e.g., changes in share price) are not included in the transaction price and would be recognised, if required, as a gain or loss in accordance with other accounting standards, but would not be recognised as revenue from contracts with customers. However, in the Basis for Conclusions, the IASB observed that this issue has important interactions with other standards (including IFRS 2 and IAS 21) and there was a concern about the risk of unintended consequences. Therefore, the Board decided that, if needed, these issues would be considered more comprehensively in a separate project.[225] The IASB acknowledged in the Basis for Conclusions, that the use of a measurement date other than contract inception would not be precluded under IFRS. Consequently, it is possible that diversity between IFRS and US GAAP entities may arise in practice. Unlike US GAAP, legacy IFRS did not contain specific requirements regarding the measurement date for non-cash consideration related to revenue transactions. As such, the IASB does not expect IFRS 15 to create more diversity than previously existed in relation to this issue.[226]

The FASB's standard also specifies that when the variability of non-cash consideration is due to both the form of the consideration and for other reasons, the constraint on variable consideration would apply only to the variability for reasons other than its form. While IFRS 15 does not have a similar requirement, the Board noted in the Basis for Conclusions that it decided to constrain variability in the estimate of the fair value of the non-cash consideration if that variability relates to changes in the fair value for reasons other than the form of the consideration. It also noted the view of some TRG members that, in practice, it might be difficult to distinguish between variability in the fair value due to the form of the consideration and other reasons, in which case applying the variable consideration constraint to the whole estimate of the non-cash consideration might be more practical.[227] However, for reasons similar to those on the measurement date for non-cash consideration, the IASB decided not to have a similar requirement to that of the FASB's standard. Consequently, the IASB acknowledged that differences may arise between an entity reporting under IFRS and an entity reporting under US GAAP.[228]

[225] IFRS 15.BC254C.
[226] IFRS 15.BC254E.
[227] IFRS 15.BC252.
[228] IFRS 15.BC254H.

5.6.2 Barter transactions (updated October 2020)

An entity may enter into barter transactions to provide goods or services in exchange for receiving similar or dissimilar goods or services from its customers. In some cases, barter transactions may include cash consideration in addition to the non-cash consideration. IFRS 15 does not contain specific requirements for barter transactions. Therefore, significant judgement and consideration of the specific facts and circumstances will be needed when accounting for such transactions.

Aspects of the standard that will be particularly important to consider include, but are not limited to:

- *Understanding whether the transaction is within the scope of the standard* – barter transactions involve non-monetary exchanges. Therefore, an entity first needs to determine whether the barter transaction involves a non-monetary exchange between entities in the same line of business to facilitate sales to (potential) customers. If it does, it is excluded from the scope of IFRS 15 (see section 2.1.1). For barter transactions not subject to this scope exclusion (i.e., they are within the scope of IFRS 15), an entity needs to understand whether there is vendor-customer relationship with the counterparty and whether the transaction is in the ordinary course of its business. This is because IFRS 15 only applies to contracts that provide goods or services to customers in the ordinary course of business (see sections 2.1 and 2.3).
- *Determining whether the transaction has commercial substance (such that the contract meets the criteria to be considered a contract under the five-step model in IFRS 15)* – exchanging goods or services in a barter transaction may lack commercial substance. An entity needs to determine whether the risk, timing or amount of an entity's future cash flows change as a result of the barter transaction (see section 3.1.4).
- *Identifying the promised goods or services to be transferred to the customer* – barter transactions may involve the exchange of a good or service, but not necessarily the transfer of its control. An entity needs to understand whether the customer will obtain control of a good or service (see section 7). That is, whether there is a promised good or service in the contract (see section 4.1).
- *Determining whether the entity will obtain control of any non-cash consideration* – barter transactions involve the exchange of non-cash items. Only non-cash items for which the entity obtains control from the customer would be non-cash consideration for purposes of applying the standard (as noted above in this section).
- *Determining the fair value of any non-cash consideration received from the customer (see section 5.6)* – in order to recognise revenue in the barter transaction, the non-cash consideration obtained from a customer needs to be measured either: (a) directly, at its fair value if it can be reasonably estimated; or (b) indirectly, by reference to the stand-alone selling price of the promised good or service transferred to the customer if the fair value of the non-cash consideration cannot be reasonably estimated. IFRS 15 does not permit an entity to avoid recognising revenue if the fair value cannot be estimated reliably. Therefore, if the transaction is within the scope of IFRS 15, revenue must be recognised.

5.7 Consideration paid or payable to a customer (updated October 2020)

Many entities make payments to their customers. In some cases, the consideration paid or payable represents purchases by the entity of goods or services offered by the customer that satisfy a business need of the entity. In other cases, the consideration paid or payable represents incentives given by the entity to entice the customer to purchase, or continue purchasing, its goods or services.

The standard provides the following requirements for consideration paid or payable to a customer:

Extract from IFRS 15

70. Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 26–30) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 50–58.

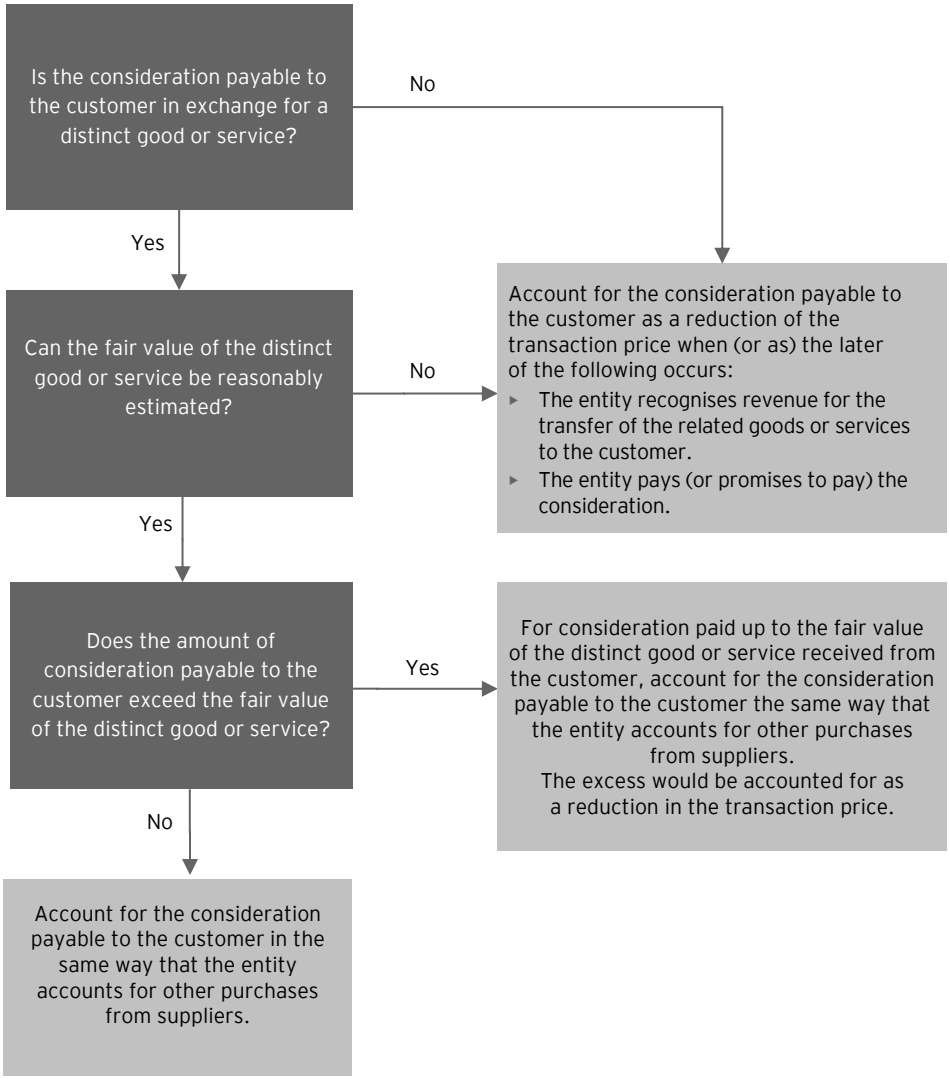
71. If consideration payable to a customer is a payment for a distinct good or service from the customer, then an entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers. If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, then the entity shall account for such an excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it shall account for all of the consideration payable to the customer as a reduction of the transaction price.

72. Accordingly, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity shall recognise the reduction of revenue when (or as) the later of either of the following events occurs:

(a) the entity recognises revenue for the transfer of the related goods or services to the customer; and

(b) the entity pays or 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 practices.

The following flow chart illustrates these requirements:



The standard indicates that an entity accounts for the consideration payable to a customer, regardless of whether the purchaser receiving the consideration is a direct or indirect customer of the entity. This includes consideration to any purchasers of the entity's products at any point along the distribution chain. This would include entities that make payments to the customers of resellers or distributors that purchase directly from the entity (e.g., manufacturers of breakfast cereals may offer coupons to end-consumers, even though their direct customers are the grocery stores that sell to end-consumers). The requirements in IFRS 15 apply to entities that derive revenue from sales of services, as well as entities that derive revenue from sales of goods.

Frequently asked questions

Question 5-26: Who is considered to be an entity's customer when applying the requirements for consideration payable to a customer? [TRG meetings 30 March 2015 – Agenda paper no. 28; and 13 July 2015 – Agenda paper no. 37]

TRG members generally agreed that the requirements for consideration payable to a customer apply to all payments made to entities/customers in the distribution chain for that contract. However, they agreed that there could also be situations in which the requirements would apply to payments made to any customer of an entity's customer outside the distribution chain if both parties are considered the entity's customers. For example, in an arrangement with a principal, an agent and an end-customer, an agent may conclude that its only customer is the principal or it may conclude that it has two customers – the principal and the end-customer. Regardless of this assessment, an agent's payment to a principal's end-customer that was contractually required based on an agreement between the entity (agent) and the principal would represent consideration payable to a customer. Absent similar contract provisions that clearly indicate when an amount is consideration payable, TRG members agreed that agents need to evaluate their facts and circumstances to determine whether payments made to an end-customer would be considered a reduction of revenue or a marketing expense.

5.7.1 Forms of consideration paid or payable to a customer (updated October 2020)

Consideration paid or payable to customers commonly takes the form of discounts and coupons, among others. Furthermore, the promise to pay the consideration may be implied by the entity's customary business practice, as stated in IFRS 15.72.

Since consideration paid or payable to a customer can take many different forms, entities have to carefully evaluate each transaction to determine the appropriate treatment of such amounts (i.e., as payment for a distinct good or service, a reduction of the transaction price or a combination of both, as illustrated in the flowchart in section 5.7). Some common examples of consideration paid to customers are given below:

- **Slotting fees** — Manufacturers of consumer products commonly pay retailers fees to have their goods displayed prominently on store shelves. Generally, such fees do not provide a distinct good or service to the manufacturer and are treated as a reduction of the transaction price.
- **Co-operative advertising arrangements** — In some arrangements, an entity agrees to reimburse a reseller for a portion of costs incurred by the reseller to advertise the entity's products. The determination of whether the payment from the vendor is in exchange for a distinct good or service at fair value depends on a careful analysis of the facts and circumstances of the contract.
- **Price protection** – An entity may agree to reimburse a retailer up to a specified amount for shortfalls in the sales price received by the retailer for the entity's products over a specified period of time. Normally such fees do not provide a distinct good or service to the manufacturer and are treated as a reduction of the transaction price (see Question 5-7 in section 5.2.1).

- **Coupons and rebates** - An indirect customer of an entity may receive a refund of a portion of the purchase price of the product or service acquired by returning a form to the retailer or the entity. Generally, such fees do not provide a distinct good or service to the manufacturer and are treated as a reduction of the transaction price.
- **'Pay-to-play' arrangements** — In some arrangements, an entity pays an upfront fee to the customer prior to, or in conjunction with, entering into a contract. In most cases, these payments are not associated with any distinct good or service to be received from the customer and are treated as a reduction of the transaction price.
- **Purchase of goods or services** — Entities often enter into supplier-vendor arrangements with their customers in which the customers provide them with a distinct good or service. For example, a software entity may buy its office supplies from one of its software customers. In such situations, the entity has to carefully determine whether the payment made to the customer is solely for the goods or services received or whether part of the payment is actually a reduction of the transaction price for the goods or services the entity is transferring to the customer.

Frequently asked questions

Question 5-27: Which payments to a customer are within the scope of the requirements for consideration payable to a customer? [TRG meetings 30 March 2015 – Agenda paper no. 28; and 13 July 2015 – Agenda paper no. 37]

TRG members generally agreed that an entity may not need to separately analyse each payment to a customer if it is apparent that the payment is for a distinct good or service acquired in the normal course of business at a market price. However, if the business purpose of a payment to a customer is unclear or the goods or services are acquired in a manner that is inconsistent with market terms that other entities would receive when purchasing the customer's good or services, the payment needs to be evaluated under these requirements.

In the Basis for Conclusions, the IASB noted that the amount of consideration received from a customer for goods or services and the amount of any consideration paid to that customer for goods or services may be linked even if they are separate events.[229]

[229] IFRS 15.BC257.

FASB differences

In 2018, the FASB issued an amendment to simplify the accounting for share-based payment awards to non-employees, including an amendment to ASC 606 to clarify that equity instruments granted to customers in conjunction with selling goods or services (e.g., shares, options) are within the scope of the requirements for consideration payable to customers.[230] The IASB has not proposed any similar amendments to IFRS 15. Therefore, entities applying IFRS could reach different accounting conclusions from those applying US GAAP. For further discussion, see Question 2-13 in section 2.5.

In 2019, the FASB issued another amendment that requires entities to measure and classify share-based payment awards (both equity-classified and liability-classified) granted to a customer in a revenue arrangement and are not in exchange for a distinct good or service in accordance with ASC 718, *Compensation – Stock Compensation*.[231] The IASB has not proposed any similar amendments.

5.7.2 Classification and measurement of consideration paid or payable to a customer (updated October 2020)

To determine the appropriate accounting treatment (and as illustrated in the flow chart in section 5.7), an entity must first determine whether the consideration paid or payable to a customer is a payment for a distinct good or service. If it is not in exchange for a distinct good or service, an entity accounts for consideration payable to a customer as a reduction in the transaction price. This is because IFRS 15.70 states that "an entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment is for a distinct good or service" (see section 5.7). That is, for a payment by the entity to a customer to be treated as something other than a reduction of the transaction price, the good or service provided by the customer must be distinct (as discussed in section 4.2.1).

If it is in exchange for a distinct good or service at fair value, an entity accounts for consideration payable to a customer in the same way it accounts for other purchases from suppliers. However, as noted in IFRS 15.71, if the payment to the customer is in excess of the fair value of the distinct good or service received, the entity must account for such excess as a reduction of the transaction price. In the event that the entity cannot reasonably estimate the fair value of the good or service received from the customer, it will need to account for all of the consideration payable to the customer as a reduction in the transaction price.

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230 ASU 2018-07, *Compensation – Stock Compensation (718): Improvements to Nonemployee Share-Based Payment accounting*.

231 ASU 2019-08, *Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Codification Improvements—Share-Based Consideration Payable to a Customer*.

Illustration 5-5 — Consideration paid to a customer in exchange for a distinct good or service

Entity A enters into a contract to sell goods to Customer B in the ordinary course of business in exchange for cash consideration. Separately, Entity A enters into an agreement to purchase market research from Customer B related to the launch of a new product in exchange for cash consideration. The two contracts were not negotiated in contemplation of one another.

Entity A elects to purchase the market research, rather than internally developing such knowledge because of Customer's B expertise in this area. Entity A could purchase similar services from a non-customer.

Based on an evaluation of the circumstances, the cash consideration paid to the customer is in return for Customer B providing distinct services to Entity A. To reach this conclusion, Entity A considers the requirements in IFRS 15.27-30 and concludes that the market research services are capable of being distinct, as well as separately identifiable (or distinct within the context of the contract), from Entity A's sale of its goods to Customer B.

Entity A determines that market research is capable of being distinct from the sale of its goods to Customer B because the market research could be purchased from a non-customer. Therefore, Entity A is able to demonstrate that the market research can provide benefits on its own or with other readily available resources.

Entity A determines that the market research is distinct within the context of the contract because of the following:

- Customer B is not providing a significant service of integrating the market research with the purchases of Entity A's goods because the promises to Entity A are not a combined output of integrated goods or services.
- The market research provided by Customer B does not modify or customise the purchases of Entity A's goods. The market research and the purchases of goods are not being assembled together to produce a combined output.
- The market research is not highly interrelated or interdependent with the sale of Entity A's goods because the market research is not needed for Customer B to purchase the goods. That is, there is no significant two-way dependency between the promises.

Entity A accounts for the cash consideration paid to Customer B in the same way that it accounts for other purchases from suppliers, provided that the cash consideration paid does not exceed the fair value of the distinct services received from Customer B. If the amount of cash consideration paid by Entity A exceeds the fair value of the distinct services, that excess amount would be characterised as a reduction of the transaction price of the goods sold to Customer B in Entity A's income statement.

In many cases, determining the amount of consideration payable to a customer (e.g., cash amounts an entity pays to a customer) will be straightforward. However, if the consideration paid or payable to a customer includes a variable amount, IFRS 15.70 notes that an entity would estimate the amount using the variable consideration requirements in IFRS 15.50-58 (see section 5.2).

5.7.3 Timing of recognition of consideration paid or payable to a customer

If the consideration paid or payable to a customer is accounted for as a reduction of the transaction price, IFRS 15.72 states that this reduction of the transaction price (and, ultimately, revenue) is recognised at the later of when: (1) the entity recognises revenue for the transfer of the related promised goods or services to the customer; or (2) the entity pays or promises to pay the consideration (even if the payment is conditional on a future event) (see section 5.7). For example, if goods subject to a discount through a coupon are already delivered to the retailers, the discount would be recognised when the coupons are issued. However, if a coupon is issued that can be used on a new line of products that have not yet been sold to retailers, the discount would be recognised upon sale of the products to a retailer. IFRS 15.82(b) also notes that the promise to pay the consideration might be implied by an entity's customary business practices.

Certain sales incentives, such as mail-in rebates and manufacturer coupons, entitle a customer to receive a reduction in the price of goods or services by submitting a form or claim for a refund of a specified amount of the price charged to the customer at the point of sale. An entity must recognise a liability for those sales incentives at the later of: (a) when it recognises revenue on the goods or services; or (b) the date at which the sales incentive was offered. The amount of liability will be based on the estimated amount of discounts or refunds that will be claimed by customers, similar to how the entity would estimate variable consideration (see section 5.2.2).

Even if the sales incentives would result in a loss on the sale of the product or service, an entity would also recognise a liability for those sales incentives at the later of: (a) when it recognises revenue on the goods or services; or (b) the date at which the sales incentive was offered. That is, an entity would not recognise the loss before either date. However, an entity would need to consider whether the offer indicates that the net realisable value of inventories are lower than costs which will require write-down of inventories to net realisable value.[232]

To determine the appropriate timing of recognition of consideration payable to a customer, entities also need to consider the requirements for variable consideration. That is, the standard's description of variable consideration is broad and includes amounts such as coupons or other forms of credits that can be applied to the amounts owed to an entity by the customer (see section 5.2.1 above). IFRS 15 requires that all potential variable consideration be considered and reflected in the transaction price at contract inception and reassessed as the entity performs. In other words, if an entity has a history of providing this type of consideration to its customers, the requirements on estimating variable consideration would require that such amounts be considered at contract inception, even if the entity has not yet provided or explicitly promised this consideration to the customer.

[232] IAS 2.9, IAS 2.28

The TRG discussed the potential inconsistency that arises between the requirements on consideration payable to a customer and variable consideration because the requirements specific to consideration payable to a customer indicate that such amounts are not recognised as a reduction of revenue until the *later* of when:[233]

- The related sales are recognised

  Or

- The entity promises to provide such consideration.

A literal read of these requirements seems to suggest that an entity need not anticipate offering these types of programmes, even if it has a history of doing so, and would only recognise the effect of these programmes at the later of when the entity transfers the promised goods or services or makes a promise to pay the customer. Members of the TRG generally agreed that if an entity has historically provided or intends to provide this type of consideration to customers, the requirements on estimating variable consideration (i.e., IFRS 15.50-52) would require the entity to consider such amounts at contract inception when the transaction price is estimated, even if the entity has not yet provided or promised to provide this consideration to the customer.[234] If the consideration paid or payable to a customer includes variable consideration (e.g., in the form of a discount or refund for goods or services provided), an entity would use either the expected value method or most likely amount method to estimate the amount to which the entity expects to be entitled and apply the constraint to the estimate (see section 5.2.3 for further discussion) to determine the effect of the variable consideration payable to the customer.

How we see it

There was general agreement by TRG members that entities need to consider the requirements for variable consideration to determine the appropriate timing of recognition of consideration payable to a customer. Therefore, significant judgement may be needed to determine the appropriate timing of recognition.

[233] TRG Agenda paper no. 37, *Consideration Payable to a Customer*, dated 13 July 2015.
[234] TRG Agenda paper no. 44, *July 2015 Meeting – Summary of Issues Discussed and Next Steps*, dated 9 November 2015.

The standard includes the following example of consideration paid to a customer:

Extract from IFRS 15

Example 32 — Consideration payable to a customer (IFRS 15.IE160-IE162)

An entity that manufactures consumer goods enters into a one-year contract to sell goods to a customer that is a large global chain of retail stores. The customer commits to buy at least CU15 million of products during the year. The contract also requires the entity to make a non-refundable payment of CU1.5 million to the customer at the inception of the contract. The CU1.5 million payment will compensate the customer for the changes it needs to make to its shelving to accommodate the entity's products.

The entity considers the requirements in paragraphs 70–72 of IFRS 15 and concludes that the payment to the customer is not in exchange for a distinct good or service that transfers to the entity. This is because the entity does not obtain control of any rights to the customer's shelves. Consequently, the entity determines that, in accordance with paragraph 70 of IFRS 15, the CU1.5 million payment is a reduction of the transaction price.

The entity applies the requirements in paragraph 72 of IFRS 15 and concludes that the consideration payable is accounted for as a reduction in the transaction price when the entity recognises revenue for the transfer of the goods. Consequently, as the entity transfers goods to the customer, the entity reduces the transaction price for each good by 10 per cent (CU1.5 million ÷ CU15 million). Therefore, in the first month in which the entity transfers goods to the customer, the entity recognises revenue of CU1.8 million (CU2.0 million invoiced amount less CU0.2 million of consideration payable to the customer).

Frequently asked questions

Question 5-28: How should an entity account for upfront payments to a customer? [FASB TRG meeting 7 November 2016 – Agenda paper no. 59]

While the requirements for consideration payable to a customer clearly apply to payments to customers under current contracts, stakeholders have raised questions about how to account for upfront payments to potential customers and payments that relate to both current and anticipated contracts.

FASB TRG members discussed two views. Under View A, an entity would recognise an asset for the upfront payment and reduce revenue as the related goods or services (or as the expected related goods or services) are transferred to the customer. As a result, the payment may be recognised in profit or loss over a period that is longer than the contract term. Entities would determine the amortisation period based on facts and circumstances and would assess the asset for recoverability using the principles in asset impairment models in other standards. Under View B, entities would reduce revenue in the current contract by the amount of the payment. If there is no current contract, entities would immediately recognise the payment in profit or loss. FASB TRG members generally agreed that an entity needs to apply the view that best reflects the substance and economics of the payment to the customer; it would not be an accounting policy choice. Entities would evaluate the nature of the payment, the rights and obligations under the contract and whether the payment meets the definition of an asset. Some FASB TRG members noted that this evaluation was consistent with legacy US

Frequently asked questions (cont'd)

GAAP requirements for payments to customers and, therefore, similar conclusions may be reached under the revenue standard. FASB TRG members also noted that an entity's decision on which view is appropriate may be a significant judgement in the determination of the transaction price that would require disclosure under the revenue standard.

How we see it

We believe an entity has to carefully evaluate all facts and circumstances of payments made to customers to determine the appropriate accounting treatment. However, if an entity expects to generate future revenue associated with the payment, we believe an entity generally applies View A (assuming any asset recorded is recoverable). If no revenue is expected as a result of the payment, View B may be appropriate.

Frequently asked questions

Question 5-29: Would 'negative revenue' result from consideration paid or payable to a customer that exceeds the amount to which the entity expects to be entitled?

In certain arrangements, consideration paid or payable to a customer could exceed the consideration to which the entity expects to be entitled in exchange for transferring promised goods or services in a contract with a customer. In these situations, recognition of payments to the customer as a reduction of revenue could result in 'negative revenue'. IFRS 15 does not specifically address how entities should present negative revenue.

Stakeholders had asked the TRG whether an entity should reclassify negative revenue resulting from consideration paid or payable to a customer to expense and, if so, in what circumstances. The TRG did not discuss this question in detail and no additional application guidance was provided.

As discussed above, IFRS 15.70 states that an entity shall account for consideration payable to a customer as a reduction of the transaction price (and, therefore, of revenue), unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity.

Therefore, we believe it is appropriate for an entity to present payments to a customer in excess of the transaction price that are not in exchange for a distinct good or service within revenue. The question of whether negative revenue can be reclassified to expense in the income statement was raised in comment letters to the IFRS IC in September 2019. However, the Committee did not consider this question.[235]

[235] *IFRIC Update*, September 2019, available on the IASB's website.

5.8 Non-refundable upfront fees (updated October 2018)

In certain circumstances, entities may receive payments from customers before they provide the contracted service or deliver a good. Upfront fees generally relate to the initiation, activation or set-up of a good to be used or a service to be provided in the future. Upfront fees may also be paid to grant access or to provide a right to use a facility, product or service. In many cases, the upfront amounts paid by the customer are non-refundable. Examples include fees paid for membership to a health club or buying club and activation fees for phone, cable or internet services.

Entities must evaluate whether a non-refundable upfront fee relates to the transfer of a promised good or service. If it does, the entity is required to determine whether to account for the promised good or service as a separate performance obligation (see section 4).

The standard notes that, even though a non-refundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception in order to fulfil the contract, in many cases, that activity does not result in the transfer of a promised good or service to the customer.[236] Instead, in many situations, an upfront fee represents an advance payment for future goods or services.

The existence of a non-refundable upfront fee may indicate that the contract includes a renewal option for future goods or services at a reduced price (if the customer renews the agreement without the payment of an additional upfront fee). In such circumstances, an entity would need to assess whether the option is a material right (i.e., another performance obligation in the contract) (see section 4.6). If the entity concludes that the non-refundable upfront fee does not provide a material right, the fee would be part of the consideration allocable to the goods or services in the contract and would be recognised when (or as) the good or service to which the consideration was allocated is transferred to the customer. If an entity concludes that the non-refundable upfront fee provides a material right, the amount of the fee allocated to the material right would be recognised over the period of benefit of the fee, which may be the estimated customer life.

The following illustration depicts the allocation of a non-refundable upfront fee determined to be a material right:

Illustration 5-6 — Non-refundable upfront fees

A customer signs a one-year contract with a health club and is required to pay both a non-refundable initiation fee of CU150 and an annual membership fee in monthly instalments of CU40. At the end of each year, the customer can renew the contract for an additional year without paying an additional initiation fee. The customer is then required to pay an annual membership fee in monthly instalments of CU40 for each renewal period. The club's activity of registering the customer does not transfer any service to the customer and, therefore, is not a performance obligation. By not requiring the customer to pay the upfront membership fee again upon renewal, the club is effectively providing a discounted renewal rate to the customer.

[236] IFRS 15.B49.

Illustration 5-6 — Non-refundable upfront fees (cont'd)

The club determines that the renewal option is a material right because it provides a renewal option at a lower price than the range of prices typically charged for new customers. Therefore, it is a separate performance obligation. Based on its experience, the club determines that its customers, on average, renew their annual memberships twice before terminating their relationship with the club. As a result, the club determines that the option provides the customer with the right to two annual renewals at a discounted price. In this scenario, the club would allocate the total transaction consideration of CU630 (CU150 upfront membership fee + CU480 (CU40 x 12 months)) to the identified performance obligations (monthly services for the one-year contract and renewal option) based on the relative stand-alone selling price method. In accordance with IFRS 15.B40, the amount allocated to the renewal option would be recognised when, or as, the future goods or services are transferred (e.g., years two and three of the services if the renewal option is fully exercised) or when the renewal option expires.

Alternatively, the club could value the option by 'looking through' to the optional goods or services using the practical alternative provided in IFRS 15.B42 (see section 6.1.5). In that case, the club would determine that the total hypothetical transaction price (for purposes of allocating the transaction price to the option) is the sum of the upfront fee plus three years of service fees (i.e., CU150 + CU1,440) and would allocate that amount to all of the services expected to be delivered or 36 months of membership (or CU44.17 per month). Therefore, the total consideration in the contract of CU630 would be allocated to the 12 months of service (CU530 (CU44.17 x 12 months)) with the remaining amount being allocated to the renewal option (CU100 (CU630 – 530)). Assuming the renewal option is exercised for year 2 and year 3, the amount allocated to the renewal option (CU100) would be recognised as revenue over each renewal period. One acceptable approach would be to reduce the initial CU100 deferred revenue balance for the material right by CU4.17 each month (CU100 / 24 months remaining), assuming that the estimated renewal period of two years remains unchanged.

See sections 4.6 and 6.1.5 for a more detailed discussion of the treatment of options (including the practical alternative allowed under IFRS 15.B42) and sections 6.1 and 6.2 for a discussion of estimating stand-alone selling prices and allocating consideration using the relative stand-alone selling price method.

The standard notes that, in some cases, an entity may charge a non-refundable fee in part as compensation for costs incurred in setting up a contract (or other administrative tasks). If those set-up activities do not satisfy a performance obligation, the entity is required to disregard them (and the related costs) when measuring progress (see section 7.1.4). This is because the costs of set-up activities do not depict the transfer of services to the customer. In addition, the entity is required to assess whether costs incurred in setting up a contract are costs incurred to fulfil a contract that meet the requirements for capitalisation in IFRS 15 (see section 9.3.2).[237]

[237] IFRS 15.B51.

Frequently asked questions

Question 5-30: Over what period would an entity recognise a non-refundable upfront fee (e.g., fees paid for membership to a club, activation fees for phone, cable or internet services) that does not relate to the transfer of a good or service? [TRG meeting 30 March 2015 – Agenda paper no. 32]

TRG members generally agreed that the period over which a non-refundable upfront fee is recognised depends on whether the fee provides the customer with a material right with respect to future contract renewals (see section 4.6). For example, assume that an entity charges a one-time activation fee of CU50 to provide CU100 of services to a customer on a month-to-month basis. If the entity concludes that the activation fee provides a material right, the fee would be recognised over the service period during which the customer is expected to benefit from not having to pay an activation fee upon renewal of the service. That period may be the estimated customer life in some situations. If the entity concludes that the activation fee does not provide a material right, the fee would be recognised over the contract duration (i.e., one month).

Question 5-31: How does a utility entity determine whether a contract that includes a non-refundable upfront fee received for establishing a connection to a network (i.e., a connection fee) is within the scope of IFRS 15?

Utility entities are often responsible for constructing infrastructure (e.g., a pipe) that will physically connect a building to its network (i.e., connection) and for providing ongoing services (e.g., delivery of electricity, gas, water). In exchange, a utility entity generally charges the customer a non-refundable upfront connection fee and a separate fee for the ongoing services. Furthermore, the connection fee and/or the fee for ongoing services are often subject to rate regulation established through a formal regulatory framework that affects the rates that a utility entity is allowed to charge to its customers.

Utility entities first need to assess whether some or all of the contract is within the scope of another standard (e.g., IFRS 16, IAS 16). If the contract is partially within the scope of IFRS 15, the entity would need to separate the non-revenue components, in accordance with IFRS 15.7, and account for the remainder within the scope of IFRS 15 (see section 2.5 for further discussion).

To be within the scope of IFRS 15, a vendor-customer relationship needs to exist. Provided such goods or services are an output of the ordinary activities of the entity, we believe a vendor-customer relationship would exist (and the contract would be wholly, or partially, within the scope of the standard) if:

- The ongoing service is part of the contract or part of an associated contract for ongoing services that is combined with the contract to establish the connection if the combined contract criteria in IFRS 15.17 are met. In a rate-regulated environment, the contract to transfer ongoing services to a customer (e.g., delivery of energy) may be implied as the customer has no alternative other than purchasing the good or service from the entity that is responsible for creating the connection.

Or

- The customer obtains control of the infrastructure asset (e.g., a pipe) or the connection.

Frequently asked questions (cont'd)

Question 5-32: What factors might be relevant when a utility entity applies the application guidance to non-refundable upfront fees for establishing a connection to a network?

As discussed in Question 5-31, utility entities are often responsible for constructing infrastructure (e.g., a pipe) that will physically connect a building to its network (i.e., connection) and may receive a non-refundable upfront connection fee in exchange. Applying the non-refundable upfront fee application guidance in such contracts often requires significant judgement and depends on the facts and circumstances. For example, if more than one party is involved, the utility entity may need to consider the principal versus agent application guidance (see section 4.4) in addition to the non-refundable upfront fee application guidance.

The non-refundable upfront fee application guidance requires an entity to determine if the upfront fee is related to a distinct good or service. As part of this assessment:

- A utility entity needs to determine whether the connection is a promised good or service in the contract. It considers explicit promises in the contract and implied promises that create a valid expectation of the customer that it will transfer control of the connection to the customer. This is likely to require significant judgement if the infrastructure asset remains an asset of the utility entity.
- If the connection is a promised good or service, a utility entity needs to determine whether the promise is distinct. In particular, the assessment of whether the connection is distinct in the context of the contract is highly judgemental and must consider the specific contract with the customer, including all relevant facts and circumstances. Entities should not assume that a particular type of good or service is distinct (or not distinct) in all instances. The manner in which the promised goods and services have been bundled within a contract, if any, will affect the entity's assessment.

  As part of assessing whether the promise is distinct within the context of the contract, a utility entity considers the three factors described in IFRS 15.29, as follows:

  - Factor (a): The utility entity needs to understand the promise(s) it has made to its customers and whether it integrates them to satisfy its promise(s). For example, if it promised its customer the ongoing supply of services, it might also bear the risk for distribution of these services (including ensuring continued connection). Therefore, it may be providing a significant service of integrating promised goods or services to provide a combined output.
  - Factor (b): This factor is unlikely to be relevant in the assessment of whether connection is distinct within the context of the contract because the ongoing service and the connection are unlikely to modify or customise each other.
  - Factor (c): The utility entity has to determine whether the connection is highly interdependent and highly interrelated with the ongoing service (e.g., supply of electricity). For example, whether there is more than just a functional relationship (i.e., one item, by its nature, depends on the other) because the utility entity cannot provide ongoing services (its main output, e.g., electricity, gas, water) without the connection and the customer cannot benefit from the connection without the ongoing services (i.e., is there two-way dependency?).

Frequently asked questions (cont'd)

If the utility entity concludes that connection is not a distinct good or service, the non-refundable upfront fee is advanced payment for future goods or services and is recognised as revenue when (or as) the future goods or services are provided. As discussed above, in such situations, an entity must determine whether the non-refundable upfront fee represents an option to renew the contract at a lower price and must assesses whether the option to renew represents a material right.

Significant judgement may be needed to determine whether the customer has a material right. However, the fact that the customer remains connected to the network and does not to pay the connection fee again while in the same property, for example, might indicate that a material right exists.

If the renewal option represents a material right, the period over which the upfront fee is recognised is longer than the initial contract duration. It is likely that significant judgement will be needed to determine the appropriate period over which to recognise the upfront fee in such circumstances (see Question 5-30 above).

Question 5-33: How is consideration that was received from a customer, but not yet recognised as revenue, accounted for when the contract is cancelled?

See response to Question 3-10 in section 3.2.

5.9 Changes in the transaction price

Changes in the transaction price can occur for various reasons. See section 6.5 for additional requirements on accounting for a change in transaction price.

6. Allocate the transaction price to the performance obligations

The standard's objective for the allocation of the transaction price to the performance obligations identified in a contract is, as follows:

Extract from IFRS 15

73. The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

Once the separate performance obligations are identified and the transaction price has been determined, the standard generally requires an entity to allocate the transaction price to the performance obligations in proportion to their stand-alone selling prices (i.e., on a relative stand-alone selling price basis). The Board noted in the Basis for Conclusions that, in most cases, an allocation based on stand-alone selling prices will faithfully depict the different margins that may apply to promised goods or services.[238]

When allocating on a relative stand-alone selling price basis, any discount within the contract generally is allocated proportionately to all of the performance obligations in the contract. However, as discussed further below, there are some exceptions. For example, an entity could allocate variable consideration to a single performance obligation in some situations. IFRS 15 also contemplates the allocation of any discount in a contract to only certain performance obligations, if specified criteria are met. An entity would not apply the allocation requirements if the contract has only one performance obligation (except for a single performance obligation that is made up of a series of distinct goods or services and includes variable consideration).

6.1 Determining stand-alone selling prices (updated October 2018)

To allocate the transaction price on a relative stand-alone selling price basis, an entity must first determine the stand-alone selling price of the distinct good or service underlying each performance obligation. Under the standard, this is the price at which an entity would sell a good or service on a stand-alone (or separate) basis at contract inception.

IFRS 15 indicates the observable price of a good or service sold separately provides the best evidence of stand-alone selling price. However, in many situations, stand-alone selling prices are not readily observable. In those cases, the entity must estimate the stand-alone selling price. The standard includes the following requirements on estimating stand-alone selling prices:

Extract from IFRS 15

78. If a stand-alone selling price is not directly observable, an entity shall estimate the stand-alone selling price at an amount that would result in the allocation of the transaction price meeting the allocation objective in paragraph 73. When estimating a stand-alone selling price, an entity shall consider all information (including market conditions, entity-specific factors

[238] IFRS 15.BC266.

Extract from IFRS 15 (cont'd)

and information about the customer or class of customer) that is reasonably available to the entity. In doing so, an entity shall maximise the use of observable inputs and apply estimation methods consistently in similar circumstances.

79. Suitable methods for estimating the stand-alone selling price of a good or service include, but are not limited to, the following:

(a) Adjusted market assessment approach—an entity could evaluate the market in which it sells goods or services and estimate the price that a customer 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.

(b) Expected cost plus a margin approach—an entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service.

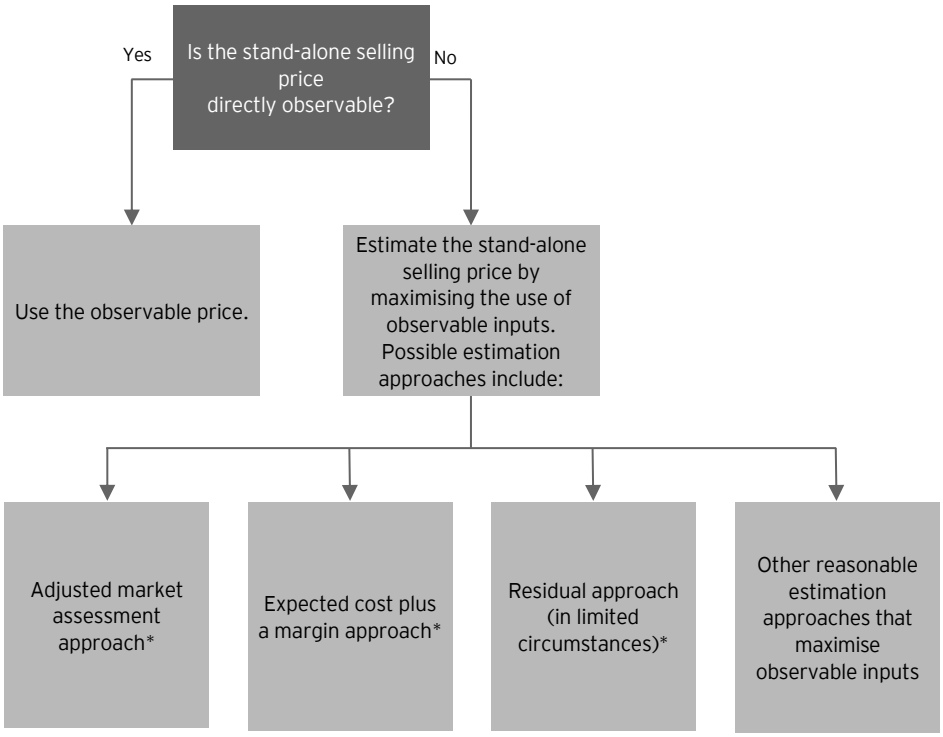
(c) Residual approach—an entity may estimate the stand-alone selling price by reference to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract. However, an entity may use a residual approach to estimate, in accordance with paragraph 78, the stand-alone selling price of a good or service only if one of the following criteria is met:

    (i) the entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts (ie the selling price is highly variable because a representative stand-alone selling price is not discernible from past transactions or other observable evidence); or

    (ii) the entity has not yet established a price for that good or service and the good or service has not previously been sold on a stand-alone basis (ie the selling price is uncertain).

80. A combination of methods may need to be used to estimate the stand-alone selling prices of the goods or services promised in the contract if two or more of those goods or services have highly variable or uncertain stand-alone selling prices. For example, an entity may use a residual approach to estimate the aggregate stand-alone selling price for those promised goods or services with highly variable or uncertain stand-alone selling prices and then use another method to estimate the stand-alone selling prices of the individual goods or services relative to that estimated aggregate stand-alone selling price determined by the residual approach. When an entity uses a combination of methods to estimate the stand-alone selling price of each promised good or service in the contract, the entity shall evaluate whether allocating the transaction price at those estimated stand-alone selling prices would be consistent with the allocation objective in paragraph 73 and the requirements for estimating stand-alone selling prices in paragraph 78.

The following flow chart illustrates how an entity might determine the stand-alone selling price of a good or service, which may include estimation:



* See section 6.1.2 for further discussion of these estimation approaches, including when it might be appropriate to use a combination of approaches.

Stand-alone selling prices are determined at contract inception and are not updated to reflect changes between contract inception and when performance is complete. For example, assume an entity determines the stand-alone selling price for a promised good using the expected cost plus a margin approach and, before it can finish manufacturing and deliver that good, the underlying cost of the materials doubles. In such a situation, the entity would not revise its stand-alone selling price used for this contract. However, for future contracts involving the same good, the entity would need to determine whether the change in circumstances (i.e., the significant increase in the cost to produce the good) warrants a revision of the stand-alone selling price. If so, the entity would use that revised price for allocations in future contracts (see section 6.1.3).

Furthermore, if the contract is modified and that modification is treated as a termination of the existing contract and the creation of a new contract (see section 3.4.2), the entity would update its estimate of the stand-alone selling price at the time of the modification. If the contract is modified and the modification is treated as a separate contract (see section 3.4.1), the accounting for the original contact would not be affected (and the stand-alone selling prices of the underlying goods or services would not be updated), but the stand-alone selling prices of the distinct goods or services of the new, separate contract would have to be determined at the time of the modification.

6.1.1 Factors to consider when estimating the stand-alone selling price

To estimate the stand-alone selling price (if not readily observable), an entity may consider the stated prices in the contract. However, the standard says an entity cannot presume that a contractually stated price, or a list price, for a good or service is the stand-alone selling price. In estimating a stand-alone selling price, an "entity shall consider all information (including market conditions, entity-specific factors and information about the customer or class of customer) that is reasonably available to the entity"[239]. An entity also needs to maximise the use of observable inputs in its estimate. This is a very broad requirement for which an entity needs to consider a variety of data sources.

The following list, which is not all-inclusive, provides examples of market conditions to consider:

- Potential limits on the selling price of the product
- Competitor pricing for a similar or identical product
- Market awareness and perception of the product
- Current market trends that are likely to affect the pricing
- The entity's market share and position (e.g., the entity's ability to dictate pricing)
- Effects of the geographic area on pricing
- Effects of customisation on pricing
- Expected life of the product, including whether significant technological advances are expected in the market in the near future

Examples of entity-specific factors include:

- Profit objectives and internal cost structure
- Pricing practices and pricing objectives (including desired gross profit margin)
- Effects of customisation on pricing
- Pricing practices used to establish pricing of bundled products
- Effects of a proposed transaction on pricing (e.g., the size of the deal, the characteristics of the targeted customer)
- Expected life of the product, including whether significant entity-specific technological advances are expected in the near future

To document its estimated stand-alone selling price, an entity should consider describing the information that it has considered (e.g., the factors listed above), especially if there is limited observable data or none at all.

[239] IFRS 15.78.

6.1.2 Possible estimation approaches (updated October 2018)

IFRS 15.79 discusses three estimation approaches: (1) the adjusted market assessment approach; (2) the expected cost plus a margin approach; and (3) a residual approach. All of these are discussed further below. When applying IFRS 15, an entity may need to use a different estimation approach for each of the distinct goods or services underlying the performance obligations in a contract. In addition, an entity may need to use a combination of approaches to estimate the stand-alone selling prices of goods or services promised in a contract, if two or more of those goods or services have highly variable or uncertain stand-alone selling prices.

Furthermore, these are not the only estimation approaches permitted. IFRS 15 allows any reasonable estimation approach, as long as it is consistent with the notion of a stand-alone selling price, maximises the use of observable inputs and is applied on a consistent basis for similar goods or services and customers.

In some cases, an entity may have sufficient observable data to determine the stand-alone selling price. For example, an entity may have sufficient stand-alone sales of a particular good or service that provide persuasive evidence of the stand-alone selling price of that particular good or service. In such situations, no estimation would be necessary.

In many instances, an entity may not have sufficient stand-alone sales data to determine the stand-alone selling price based solely on those sales. In those instances, it must maximise the use of whatever observable inputs it has available in order to make its estimate. That is, an entity would not disregard any observable inputs when estimating the stand-alone selling price of a good or service. An entity should consider all factors contemplated in negotiating the contract with the customer and the entity's normal pricing practices factoring in the most objective and reliable information that is available. While some entities may have robust practices in place regarding the pricing of goods or services, some may need to improve their processes to develop estimates of stand-alone selling prices.

The standard includes the following estimation approaches:

- **Adjusted market assessment approach** — this approach focuses on the amount that the entity believes the market in which it sells goods or services is willing to pay for a good or service. For example, an entity might refer to competitors' prices for similar goods or services and adjust those prices, as necessary, to reflect the entity's costs and margins. When using the adjusted market assessment approach, an entity considers market conditions, such as those listed in section 6.1.1. Applying this approach is likely to be easiest when an entity has sold the good or service for a period of time (such that it has data about customer demand) or a competitor offers similar goods or services that the entity can use as a basis for its analysis. Applying this approach may be difficult when an entity is selling an entirely new good or service because it may be difficult to anticipate market demand. In these situations, entities may want to use the market assessment approach, with adjustments, as necessary, to reflect the entity's costs and margins, in combination with other approaches to maximise the use of observable inputs (e.g., using competitors' pricing, adjusted based on the market assessment approach in combination with an entity's planned internal pricing strategies if the performance obligation has never been sold separately).

- **Expected cost plus margin approach** — this approach focuses more on internal factors (e.g., the entity's cost basis), but has an external component as well. That is, the margin included in this approach must reflect the margin the market would be willing to pay, not just the entity's desired margin. The margin may have to be adjusted for differences in products, geographies, customers and other factors. The expected cost plus margin approach may be useful in many situations, especially when the performance obligation has a determinable direct fulfilment cost (e.g., a tangible product or an hourly service). However, this approach may be less helpful when there are no clearly identifiable direct fulfilment costs or the amount of those costs is unknown (e.g., a new software licence or specified upgrade rights).
- **Residual approach** – this approach allows an entity to estimate the stand-alone selling price of a promised good or service as the difference between the total transaction price and the observable (i.e., not estimated) stand-alone selling prices of other promised goods or services in the contract, provided one of two criteria in IFRS 15.79(c) are met. The standard indicates that this approach can only be used for contracts with multiple promised goods or services when the selling price of one or more of the promised goods or services is unknown (either because the historical selling price is highly variable or because the goods or services have not yet been sold). As a result, we expect that the use of this approach is likely to be limited. However, allowing entities to use a residual technique provides relief to entities that rarely, or never, sell goods or services on a stand-alone basis, such as entities that sell intellectual property only with physical goods or services.

  The Board noted in the Basis for Conclusions that the use of the residual approach cannot result in a stand-alone selling price of zero if the good or service is distinct.[240] This is because a good or service must have value on a stand-alone basis to be distinct. The Board also stated that, if use of the residual approach results in very little, or no, consideration being allocated to a good or service or a bundle of goods or services, an entity should re-evaluate whether the use of the residual approach is appropriate.

  An example of an appropriate use of the residual approach would be an entity that frequently sells software, professional services and maintenance, bundled together, at prices that vary widely. However, the entity also sells the professional services and maintenance individually at relatively stable prices. The Board indicated that it may be appropriate to estimate the stand-alone selling price for the software as the difference between the total transaction price and the observable selling prices of the professional services and maintenance. See Example 34, Cases B and C, from IFRS 15 (included in section 6.4) for examples of when the residual approach may or may not be appropriate.

  The Board clarified in the Basis for Conclusions that an entity could also use the residual approach if there are two or more goods or services in the contract with highly variable or uncertain stand-alone selling prices, provided that at least one of the other promised goods or services in the contract has an observable stand-alone selling price. The Board observed that, in such an instance, an entity may need to use a combination of techniques to estimate the stand-alone selling prices.[241] For example, an entity may apply the residual approach to estimate the aggregate of the stand-alone selling prices for all of the promised goods or services with highly variable or uncertain

[240] IFRS 15.BC273.
[241] IFRS 15.BC272.

stand-alone selling prices, but then use another approach (e.g., adjusted market assessment, expected cost plus margin) to estimate the stand-alone selling prices of each of those promised goods or services with highly variable or uncertain stand-alone selling prices.

The standard includes the following example in which two estimation approaches are used to estimate stand-alone selling prices of two different goods in a contract:

Extract from IFRS 15

Example 33—Allocation methodology (IFRS 15.IE164-IE166)

An entity enters into a contract with a customer to sell Products A, B and C in exchange for CU100. The entity will satisfy the performance obligations for each of the products at different points in time. The entity regularly sells Product A separately and therefore the stand-alone selling price is directly observable. The stand-alone selling prices of Products B and C are not directly observable.

Because the stand-alone selling prices for Products B and C are not directly observable, the entity must estimate them. To estimate the stand-alone selling prices, the entity uses the adjusted market assessment approach for Product B and the expected cost plus a margin approach for Product C. In making those estimates, the entity maximises the use of observable inputs (in accordance with paragraph 78 of IFRS 15). The entity estimates the stand-alone selling prices as follows:

Product	Stand-alone selling price	Method
	CU	
Product A	50	Directly observable (see paragraph 77 of IFRS 15)
Product B	25	Adjusted market assessment approach (see paragraph 79(a) of IFRS 15)
Product C	75	Expected cost plus a margin approach (see paragraph 79(b) of IFRS 15)
Total	150	

The customer receives a discount for purchasing the bundle of goods because the sum of the stand-alone selling prices (CU150) exceeds the promised consideration (CU100). The entity considers whether it has observable evidence about the performance obligation to which the entire discount belongs (in accordance with paragraph 82 of IFRS 15) and concludes that it does not. Consequently, in accordance with paragraphs 76 and 81 of IFRS 15, the discount is allocated proportionately across Products A, B and C. The discount, and therefore the transaction price, is allocated as follows:

Product	Allocated transaction price	
	CU	
Product A	33	(CU50 ÷ CU150 × CU100)
Product B	17	(CU25 ÷ CU150 × CU100)
Product C	50	(CU75 ÷ CU150 × CU100)
Total	100	

Given the flexibility provided by the standard to estimate stand-alone selling prices, it is both appropriate and necessary for entities to tailor the approach(es) used to their specific facts and circumstances. However, regardless of whether the entity uses a single approach or a combination of

approaches, it must evaluate whether the resulting allocation of the transaction price is consistent with the overall allocation objective in IFRS 15.73 and the requirements for estimating stand-alone selling prices discussed above.

In accordance with IFRS 15, an entity must make a reasonable estimate of the stand-alone selling price for the distinct good or service underlying each performance obligation if an observable selling price is not readily available. We believe entities should have sufficient information to develop a reasonable estimate, even in instances in which limited information is available.

How we see it

Entities need robust processes to estimate stand-alone selling prices. If those estimates have limited underlying observable data, it is important for entities to be able to demonstrate the reasonableness of the calculations they make in estimating stand-alone selling prices.

6.1.3 Updating estimated stand-alone selling prices (updated October 2020)

As discussed in section 6.1 above, stand-alone selling prices are determined at contract inception and are not updated to reflect changes between contract inception and when performance is complete. However, an entity needs to update its estimates of stand-alone selling prices for future transactions to reflect changes in circumstances.

IFRS 15 does not specifically address how frequently estimated stand-alone selling prices must be updated. Instead, it indicates that an entity must make this estimate for each distinct good or service underlying each performance obligation in each contract with a customer, which suggests that an entity needs to constantly update its estimates.

In practice, we expect that entities will be able to consider their own facts and circumstances in order to determine how frequently they will need to update their estimates. If, for example, the information used to estimate the stand-alone selling price for similar transactions has not changed, an entity may determine that it is reasonable to use the previously determined stand-alone selling price.

However, in order for the changes in circumstances to be reflected in the estimate in a timely manner, we expect that an entity would formally update the estimate on a regular basis (e.g., monthly, quarterly, semi-annually). The frequency of updates should be based on the facts and circumstances of the distinct good or service underlying each performance obligation for which the estimate is made. An entity uses current information each time it develops or updates its estimate. While the estimates may be updated, the approach used to estimate stand-alone selling price does not change (i.e., an entity must use a consistent approach), unless facts and circumstances change.

6.1.4 Additional considerations for determining the stand-alone selling price (updated October 2018)

While not explicitly stated in IFRS 15, we expect that a single good or service could have more than one stand-alone selling price. That is, the entity may be willing to sell goods or services at different prices to different customers. Furthermore, an entity may use different prices in different geographies or in markets where it uses different methods to distribute its products (e.g., it may use a distributor or reseller, rather than selling directly to the end-customer) or for other reasons (e.g., different cost structures or strategies in different markets). Accordingly, an entity may need to stratify its analysis to determine

its stand-alone selling price for each class of customer, geography and/or market, as applicable.

Frequently asked questions

Question 6-1: When estimating the stand-alone selling price, does an entity have to consider its historical pricing for the sale of the good or service involved?

Yes, we believe that an entity should consider its historical pricing in all circumstances, but it may not be determinative. Historical pricing is likely to be an important input as it may reflect both market conditions and entity-specific factors and can provide supporting evidence about the reasonableness of management's estimate. For example, if management determines, based on its pricing policies and competition in the market, that the stand-alone selling price of its good or service is X, historical transactions within a reasonable range of X would provide supporting evidence for management's estimate. However, if historical pricing was only 50% of X, this may indicate that historical pricing is no longer relevant due to changes in the market, for example, or that management's estimate is flawed.

Depending on the facts and circumstances, an entity may conclude that other factors such as internal pricing policies are more relevant to its determination of a stand-alone selling price. When historical pricing has been established using the entity's normal pricing policies and procedures, it is more likely that this information will be relevant in the estimation.

If the entity has sold the product separately or has information on competitors' pricing for a similar product, it is likely that the entity would find historical data relevant to its estimate of stand-alone selling prices, among other factors. In addition, we believe it may be appropriate for entities to stratify stand-alone selling prices based on: the type or size of customer; the amount of product or services purchased; the distribution channel; the geographic location; or other factors.

Question 6-2: When using an expected cost plus margin approach to estimate a stand-alone selling price, how would an entity determine an appropriate margin?

When an entity elects to use the expected cost plus margin approach, it is important for the entity to use an appropriate margin. Determining an appropriate margin may require the use of significant judgement and involve the consideration of many market conditions and entity-specific factors, discussed in section 6.1.1. For example, it would not be appropriate to determine that the entity's estimate of stand-alone selling price is equivalent to cost plus a 30% margin if a review of market conditions demonstrates that customers are only willing to pay the equivalent of cost plus a 12% margin for a comparable product. Similarly, it would be inappropriate to determine that cost plus a specified margin represents the stand-alone selling price if competitors are selling a comparable product at twice the determined estimate. Furthermore, the determined margin may have to be adjusted for differences in products, geographic locations, customers and other factors.

Frequently asked questions (cont'd)

Question 6-3: When estimating the stand-alone selling price of a good or service, can an entity estimate a range of prices or does it have to identify a point estimate?

Entities might use a range of prices to help estimate the stand-alone selling price of a good or service. We believe it is reasonable for an entity to use such a range for the purpose of assessing whether a stand-alone selling price (i.e., a single price) that the entity intends to use is reasonably within that range. That is, we do not believe that an entity is required to determine a point estimate for each estimated stand-alone selling price if a range is a more practical means of estimating the stand-alone selling price for a good or service.

The objective of the standard is to allocate the transaction price to each performance obligation in "an amount that depicts the amount of consideration for which the entity expects to be entitled in exchange for transferring the promised good or service to the customer". While the standard does not address ranges of estimates, using a range of prices would not be inconsistent with the objective of the standard. The only requirements in the standard are that an entity maximise its use of observable inputs and apply the estimation approaches consistently. Therefore, the use of a range would also be consistent with these principles.

Practices we have observed include an entity establishing that a large portion of the stand-alone selling prices falls within a narrow range (e.g., by reference to historical pricing). We believe the use of a narrow range is acceptable for determining estimates of stand-alone selling prices under the standard because it is consistent with the standard's principle that an entity must maximise its use of observable inputs. While the use of a range may be appropriate for estimating the stand-alone selling price, we believe that some approaches to identifying this range do not meet the requirements of IFRS 15. For example, it would not be appropriate for an entity to determine a range by estimating a single price point for the stand-alone selling price and then adding an arbitrary range on either side of that point estimate, nor would it be appropriate to take the historical prices and expand the range around the midpoint until a significant portion of the historical transactions fall within that band. The wider the range necessary to capture a high proportion of historical transactions, the less relevant it is in terms of providing a useful data point for estimating stand-alone selling prices.

Management's analysis of market conditions and entity-specific factors could support it in determining the best estimate of the stand-alone selling price. The historical pricing data from transactions, while not necessarily determinative, could be used as supporting evidence for management's conclusion. This is because it is consistent with the standard's principle that an entity must maximise its use of observable inputs. However, management would need to analyse the transactions that fall outside the range to determine whether they have similar characteristics and, therefore, need to be evaluated as a separate class of transactions with a different estimated selling price.

Frequently asked questions (cont'd)

If the entity has established a reasonable range for the estimated stand-alone selling prices and the stated contractual price falls within that range, it may be appropriate to use the stated contractual price as the stand-alone selling price in the allocation calculation. However, if the stated contractual price for the good or service falls outside of the range, the stand-alone selling price needs to be adjusted to a point within the established range in order to allocate the transaction price on a relative stand-alone selling price basis. In these situations, the entity would need to determine which point in the range is most appropriate to use (e.g., the midpoint of the range or the outer limit nearest to the stated contractual price) when performing the allocation calculation.

Question 6-4: How should an entity evaluate a contract where the total transaction price exceeds the sum of the stand-alone selling prices?

If the total transaction price exceeds the sum of the stand-alone selling prices it may indicate that the customer is paying a premium for bundling the goods or services in the contract. This situation is likely to be rare because most customers expect to receive a discount for purchasing a bundle of goods or services. If a premium exists after determining the stand-alone selling prices of each good or service, the entity needs to evaluate whether it properly identified both the estimated stand-alone selling prices (i.e., are they too low?) and the number of performance obligations in the contract. However, if the entity determines that a premium does exist after this evaluation, we believe the entity would need to allocate the premium in a manner consistent with the standard's allocation objective, which would typically be on a relative stand-alone selling price basis.

6.1.5 Measurement of options that are separate performance obligations (updated September 2019)

An entity that determines that a customer option for additional goods or services is a separate performance obligation (because the option provides the customer with a material right, as discussed in section 4.6) needs to determine the stand-alone selling price of the option.

If the option's stand-alone selling price is not directly observable, the entity needs to estimate it. In doing so, IFRS 15.B42 requires an entity to take into consideration any discount the customer would receive in a stand-alone transaction and the likelihood that the customer would exercise the option.

Generally, option pricing models consider both the intrinsic value of the option (i.e., the value of the option if it were exercised today) and its time value (e.g., the option may be more or less valuable based on the amount of time until its expiration date and/or the volatility of the price of the underlying good or service). However, an entity is only required to measure the intrinsic value of the option when estimating the stand-alone selling price of the option. In the Basis for Conclusions, the Board noted that the benefits of valuing the time value component of an option would not justify the cost of doing so.[242] Example 49 in the standard (included in section 4.6) illustrates the

[242] IFRS 15.BC390.

measurement of an option determined to be a material right under IFRS 15.B42. The following example also illustrates this concept:

Illustration 6-1 — Estimating the stand-alone selling price of options that are separate performance obligations

Publisher A sells a physical textbook for CU10 and offers the customer an option to purchase the digital version of the publication at 50% off the retail price of CU8. The typical discount for digital versions is 15%. Therefore, Publisher A concludes that this discount exceeds the typical discount offered to customers and that it provides the customer with a material right.

To estimate the stand-alone selling price of the option, Publisher A estimates there is a 50% likelihood that a customer will redeem the discount option. Therefore, Publisher A's estimated stand-alone selling price of the discount option is CU1.40 (CU8 digital price x 35% incremental discount x 50% likelihood of exercising the option).

Publisher A allocates CU1.23 (CU10 x [CU1.40 / (CU1.40 + CU10)]) of the transaction price to the discount option and recognises revenue for the option when the customer exercises its right for the digital version or when the option expires. Publisher A allocates CU8.77 (CU10 – CU1.23) to the physical book and recognises revenue for the physical book when it transfers control of the book to the customer.

IFRS 15.B43 provides an alternative to estimating the stand-alone selling price of an option. This practical alternative applies when the additional goods or services are both: (1) similar to the original goods or services in the contract (i.e., the entity continues to provide what it was already providing);[243] and (2) provided in accordance with the terms of the original contract. The standard indicates that this practical alternative generally applies to options for contract renewals (i.e., the renewal option approach).

The Basis for Conclusions states that customer loyalty points and discount vouchers typically do not meet the criteria for use of this practical alternative. This is because customer loyalty points and discount vouchers are redeemable for goods or services that may differ in nature from those offered in the original contract and the terms of the original contract do not restrict the pricing of the additional goods or services. For example, if an airline offers flights to customers in exchange for points from its frequent flyer programme, the airline is not restricted because it can subsequently determine the number of points that are required to be redeemed for any particular flight.[244]

Under the practical alternative, a portion of the transaction price is allocated to the option (i.e., the material right that is a performance obligation) by reference to the total goods or services expected to be provided to the customer (including expected renewals) and the corresponding expected consideration. That is, the total amount of consideration expected to be received from the customer (including consideration from expected renewals) is allocated to the total goods or services expected to be provided to the customer, including those from the expected contract renewals. The amount allocated to the goods or services that the entity is required to transfer to the customer under the contract (i.e., excluding the optional goods or services that will be transferred if the customer exercises the renewal option(s)) is then subtracted from the total amount of consideration received (or that will be received) for transferring those goods or services. The difference is the amount that is allocated to the

[243] IFRS 15.BC394.
[244] IFRS 15.BC394 and BC395.

option at contract inception. An entity using this alternative needs to apply the constraint on variable consideration (as discussed in section 5.2.3) to the estimated consideration for the optional goods or services prior to performing the allocation (see Illustration 6-2, Scenario B below).

It is important to note that the calculation of total expected consideration (i.e., the hypothetical transaction price), including consideration related to expected renewals, is only performed for the purpose of allocating a portion of the hypothetical transaction price to the option at contract inception. It does not change the enforceable rights or obligations in the contract, nor does it affect the actual transaction price for the goods or services that the entity is presently obliged to transfer to the customer (which would not include expected renewals). Accordingly, the entity would not include any remaining hypothetical transaction price in its disclosure of remaining performance obligations (see section 10.5.1). In this respect, the practical alternative is consistent with the conclusion in Question 4-14 (see section 4.6). That is, even if an entity may think that it is almost certain that a customer will exercise an option to buy additional goods or services, an entity does not include the additional goods or services underlying the option as promised goods or services (or performance obligations), unless there are substantive contractual penalties.

Subsequent to contract inception, if the actual number of contract renewals is different from an entity's initial expectations, the entity updates the hypothetical transaction price and allocation. However, as discussed in section 6.1, the estimate of the stand-alone selling price at contract inception is not updated. See Illustration 6-2, Scenario B below for an example of how an entity could update its practical alternative calculation based on a change in expectations.

The following example illustrates the two possible approaches for measuring options included in a contract:

Illustration 6-2 — Measuring an option

A machinery maintenance contract provider offers a promotion to new customers who pay full price for the first year of maintenance coverage that grants them an option to renew the services for up to two years at a discount. The entity regularly sells maintenance coverage for CU750 per year. With the promotion, the customer may renew the one-year maintenance at the end of each year for CU600. The entity concludes that the ability to renew is a material right because the customer would receive a discount that exceeds any discount available to other customers. The entity also determines that no directly observable stand-alone selling price exists for the option to renew at a discount.

Illustration 6-2 — Measuring an option (cont'd)

Scenario A – Estimate the stand-alone selling price of the option directly (IFRS 15.B42)

Since the entity has no directly observable evidence of the stand-alone selling price for the renewal option, it estimates the stand-alone selling price of an option for a CU150 discount on the renewal of service in years two and three. When developing its estimate, the entity considers factors such as the likelihood that the option will be exercised and the price of comparable discounted offers. For example, the entity may consider the selling price of an offer for a discounted price of similar services found on a 'deal of the day' website.

The option will then be included in the relative stand-alone selling price allocation. In this example, there are two performance obligations: one-year of maintenance services; and an option for discounted renewals. The consideration of CU750 is allocated between these two performance obligations based on their relative stand-alone selling prices.

Example 49 in the standard (included in section 4.6) illustrates the estimation of the stand-alone selling price of an option determined to be a material right under IFRS 15.B42.

Scenario B – Practical alternative to estimating the stand-alone selling price of the option using the renewal option approach (IFRS 15.B43)

If the entity chooses to use the renewal option approach, it allocates the transaction price to the option for maintenance services by reference to the maintenance services expected to be provided (including expected renewals) and the corresponding expected consideration. Since there is a discount offered on renewal of the maintenance service, this calculation will result in less revenue being allocated to the first year of the maintenance service when compared to the amount of consideration received for the first year of service (i.e., an amount less than CU750). The difference between the consideration received (or that will be received) for the first year of maintenance service and the revenue allocated to the first year of maintenance service (i.e., CU750) will represent the amount allocated to the option using the renewal option approach.

Assume the entity obtained 100 new customers under the promotion. Based on its experience, the entity anticipates approximately 50% attrition annually, after giving consideration to the anticipated effect that the CU150 discount will have on attrition. The entity considers the constraint on variable consideration and concludes that it is not highly probable that a significant revenue reversal will not occur. Therefore, the entity concludes that, for this portfolio of contracts, it will ultimately sell 175 contracts, each contract providing one-year of maintenance services (i.e., 100 customers in the first year, 50 customers in the second year and 25 customers in the third year).

Illustration 6-2 — Measuring an option (cont'd)

Therefore, the total consideration the entity expects to receive is CU120,000 [(100 x CU750) + (50 x CU600) + (25 x CU600)] (i.e., the hypothetical transaction price). Assuming the stand-alone selling price for each maintenance contract period is the same, the entity allocates CU685.71 (CU120,000/175) to each maintenance contract sold.

During the first year, the entity will recognise revenue of CU68,571 (100 one-year maintenance service contracts sold x the allocated price of CU685.71 per maintenance service contract). Consequently, at contract inception, the entity would allocate CU6,429 to the option to renew (CU75,000 cash received – CU68,571 revenue to be recognised in the first year).

If the actual renewals in years two and three differ from expectations, the entity would have to update the hypothetical transaction price and allocation accordingly. However, beyond stating, as discussed in section 6.1, that the estimate of the stand-alone selling prices at contract inception would not be updated, the standard is not explicit about how the entity would update the hypothetical transaction price and allocation. Below is an illustration of how an entity could update its practical alternative calculation based on a change in expectations.

For example, assume that the entity experiences less attrition than expected (e.g., 40% attrition annually, instead of 50%). Therefore, the entity's revised estimate is that it will ultimately sell 196 one-year maintenance services (100 + 60 renewals after year one + 36 renewals after year two). Accordingly, the total consideration that the entity expects to receive is CU132,600 [(100 x CU750) + (60 x CU600) + (36 x CU600)] (i.e., the updated hypothetical transaction price). The entity would not update its estimates of the stand-alone selling prices (which were assumed to be the same for each maintenance period). As such, the entity allocates CU676.53 (CU132,600/196) to each maintenance period. The entity would reduce the amount of revenue it recognises in year one by CU918 (CU68,571 – (100 x CU676.53)) because the amount allocated to the option would have been higher at contract inception.

See section 5.8 for another example of applying the practical alternative when the contract includes a non-refundable upfront fee that is deemed to be a material right.

Frequently asked questions

Question 6-5: Could the form of an option (e.g., a gift card versus a coupon) affect how an option's stand-alone selling price is estimated?

We believe that the form of an option should not affect how the stand-alone selling price is estimated. Consider, for example, a retailer that gives customers who spend more than CU100 during a specified period a CU15 discount on a future purchase in the form of a coupon or a gift card that expires two weeks from the sale date. If the retailer determines that this type of offer represents a material right (see section 4.6), it will need to allocate a portion of the transaction price to the option on a relative stand-alone selling price basis.

As discussed in section 6.1, the standard requires that an entity first look to any directly observable stand-alone selling price. This requires the retailer to consider the nature of the underlying transaction. In this example, while a customer can purchase a CU15 gift card for its face value, that transaction is not the same in substance as a transaction in which the customer is given a CU15 gift card or coupon in connection with purchasing another good or service. As such, the retailer could conclude that there is no directly observable stand-alone selling price for a 'free' gift card or coupon obtained in connection with the purchase of another good or service. It would then need to estimate the stand-alone selling price in accordance with IFRS 15.B42.

The estimated stand-alone selling price of an option given in the form of a gift card or a coupon would be the same because both estimates would reflect the likelihood that the option will be exercised (i.e., breakage, as discussed in section 7.9).

Question 6-6: Can an entity use the practical alternative when not all of the goods or services in the original contract are subject to a renewal option?

In certain instances, it might be appropriate to apply the practical alternative even if not all of the goods or services in the original contract are subject to renewal, provided that the renewal is of a good or service that is similar to that included in the original contract and follows the renewal terms included in the original contract. Consider a contract to sell hardware and a service-type warranty where the customer has the option to renew the warranty only. Furthermore, assume that the renewal option is determined to be a material right. If the terms of any future warranty renewals are consistent with the terms provided in the original contract, we believe it is reasonable to use the practical alternative when allocating the transaction price of the contract.

6.2 Applying the relative stand-alone selling price method (updated October 2018)

Once an entity has determined the stand-alone selling price for the separate goods or services in a contract, the entity allocates the transaction price to those performance obligations. The standard requires an entity to use the relative stand-alone selling price method to allocate the transaction price, except in the two specific circumstances (variable consideration and discounts), which are described in sections 6.3 and 6.4 below.

Under the relative stand-alone selling price method, the transaction price is allocated to each performance obligation based on the proportion of the stand-alone selling price of each performance obligation to the sum of the stand-alone selling prices of all of the performance obligations in the contract, as described in Illustration 6-3 below:

Illustration 6-3 — Relative stand-alone selling price allocation

Manufacturing Co. entered into a contract with a customer to sell a machine for CU100,000. The total contract price included installation of the machine and a two-year extended warranty. Assume that Manufacturing Co. determined there were three performance obligations and the stand-alone selling prices of those performance obligations were as follows: machine — CU75,000, installation services — CU14,000 and extended warranty — CU20,000.

The aggregate of the stand-alone selling prices (CU109,000) exceeds the total transaction price of CU100,000, indicating there is a discount inherent in the contract. That discount must be allocated to each of the individual performance obligations based on the relative stand-alone selling price of each performance obligation. Therefore, the amount of the CU100,000 transaction price is allocated to each performance obligation as follows:

Machine — CU68,807 (CU100,000 x (CU75,000/CU109,000))

Installation — CU12,844 (CU100,000 x (CU14,000/CU109,000))

Warranty — CU18,349 (CU100,000 x (CU20,000/CU109,000))

The entity would recognise as revenue the amount allocated to each performance obligation when (or as) each performance obligation is satisfied.

Frequently asked questions

Question 6-7: How should an entity allocate the transaction price in a contract with multiple performance obligations in which the entity acts as both a principal and an agent? [TRG meeting 18 July 2014 - Agenda paper no. 1]

The standard does not illustrate the allocation of the transaction price for a contract with multiple performance obligations in which the entity acts as both a principal and an agent (see section 4.4 for a discussion of principal versus agent considerations). Below we illustrate two acceptable ways to perform the allocation for this type of contract that are consistent with the standard's objective for allocating the transaction price. Entities need to evaluate the facts and circumstances of their contracts to make sure that the allocation involving multiple performance obligations in which an entity acts as both a principal and an agent meets the allocation objectives in IFRS 15.

Illustration 6-4 – Allocation when an entity is both a principal and an agent in a contract

Entity X sells two distinct products (i.e., Product A and Product B) to Customer Y, along with a distinct service for an aggregate contract price of CU800. Entity X is the principal for the sale of Product A and Product B, but is an agent for the sale of the service.

The stand-alone selling price of each good and service in the contract is, as follows:

Contract	Stand-alone selling price
	CU
Product A	500
Product B	300
Service	200
Total	1,000

Entity X earns a 20% commission from the third-party service provider based on the stand-alone selling price of the service. That is, Entity X earns CU40 of commission (i.e., CU200 x 20%) and remits the remaining CU160 to the third-party service provider.

Method A – Entity X determines that it has provided a single discount of CU200 (i.e., sum of stand-alone selling prices of CU1,000 less the contract price of CU800) on the bundle of goods and services sold to Customer Y in the contract (i.e., Products A and B and the service provided by the third-party). Assume that the criteria for allocating the discount to one or more, but not all, performance obligations in accordance with IFRS 15.82 are not met – see section 6.4.

In order to allocate the discount to all of the goods and services in the contract, Entity X considers the performance obligation for the agency service as part of the contract with Customer Y for purposes of allocating the transaction price. Entity X determines the stand-alone selling prices of Products A and B and the agency service and allocates the transaction price of CU640 (i.e., CU800 contract price less CU160 to be remitted to the third-party service provider) for Products A and B and the service

Frequently asked questions

Illustration 6-4 – Allocation when an entity is both a principal and an agent in a contract (cont'd)

on a relative stand-alone selling price basis. This method is illustrated, as follows:

Contract	Stand-alone selling price		Allocated transaction price
	CU		CU
Product A	500	(500 ÷ 840 × 640)	381
Product B	300	(300 ÷ 840 × 640)	229
Service	40	(40 ÷ 840 × 640)	30
Total	840		640

Method B - Entity X determines that it has provided a discount of CU200 on Products A and B since it is the principal for the transfer of those goods to Customer Y. Entity X believes the third-party service provider is a separate customer for its agency services and the commission Entity X expects to be entitled to receive for the agency service is not part of the transaction price in the contract with Customer Y. Entity X allocates a transaction price of CU600 (i.e., CU800 contract price less CU200 stand-alone selling price of service) to Product A and B on a relative stand-alone selling price basis. This method is illustrated, as follows:

Contract 1	Stand-alone selling price		Allocated transaction price
	CU		CU
Product A	500	(500 ÷ 800 × 600)	375
Product B	300	(300 ÷ 800 × 600)	225
Total	800		600

The entity would recognise CU40 separately for its earned commission on the service contract when the performance obligation for the agency service has been satisfied.

In either method, the same amount of revenue is ultimately recognised (i.e., CU640). However, the timing of revenue recognition would be different if the products and agency service are transferred to the customer at different times.

6.3 Allocating variable consideration (updated October 2020)

The relative stand-alone selling price method is the default method for allocating the transaction price. However, the Board noted in the Basis for Conclusions on IFRS 15 that this method may not always result in a faithful depiction of the amount of consideration to which an entity expects to be entitled from the customer.[245] Therefore, the standard provides two exceptions to the relative selling price method of allocating the transaction price.

The first relates to the allocation of variable consideration (see section 6.4 for the second exception on the allocation of a discount). This exception requires variable consideration to be allocated entirely to a specific part of a contract, such as one or more (but not all) performance obligations in the contract (e.g., a bonus may be contingent on an entity transferring a promised good or service within a specified period of time) or one or more (but not all) distinct goods or services promised in a series of distinct goods or services that form part of a single performance obligation (see section 4.2.2). For example, the consideration promised for the second year of a two-year cleaning service contract will increase on the basis of movements in a specified inflation index.

Two criteria must be met to apply this exception, as follows:

Extract from IFRS 15

85. An entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with paragraph 22(b) if both of the following criteria are met:

(a) the terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service); and

(b) allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in paragraph 73 when considering all of the performance obligations and payment terms in the contract.

86. The allocation requirements in paragraphs 73–83 shall be applied to allocate the remaining amount of the transaction price that does not meet the criteria in paragraph 85.

While the language in IFRS 15.85 in the extract above implies that this exception is limited to allocating variable consideration to a single performance obligation or a single distinct good or service within a series, IFRS 15.84 indicates that the variable consideration can be allocated to 'one or more, but not all', performance obligations or distinct goods or services within a series. We understand it was not the Board's intent to limit this exception to a single performance obligation or a single distinct good or service within a series, even though the standard uses a singular construction for the remainder of the discussion and does not repeat 'one or more, but not all'.

The Board noted in the Basis for Conclusions that this exception is necessary because allocating contingent amounts to all performance obligations in a contract may not reflect the economics of a transaction in all cases.[246] Allocating variable consideration entirely to a distinct good or service may be appropriate when the result is that the amount allocated to that particular

[245] IFRS 15.BC280.
[246] IFRS 15.BC278.

good or service is reasonable relative to all other performance obligations and payment terms in the contract. Subsequent changes in variable consideration must be allocated in a consistent manner.It is important to note that allocating variable consideration to one or more, but not all, performance obligations or distinct goods or services in a series is a requirement, not a policy choice. If the above criteria are met, the entity must allocate the variable consideration to the related performance obligation(s) or distinct goods or services in a series. Entities may need to exercise significant judgement to determine whether they meet the requirements to allocate variable consideration to specific performance obligations or distinct goods or services within a series.

Firstly, entities need to determine whether they meet the first criterion in IFRS 15.85, which requires that the terms of a variable payment relate specifically to either an entity's efforts to satisfy a performance obligation (or to transfer a distinct good or service that is part of a series) or a specific outcome from satisfying the performance obligation (or transferring the distinct good or service).

In performing this assessment, an entity needs to consider the nature of its promise and how the performance obligation has been defined. In addition, the entity needs to clearly understand the variable payment terms and how they align with the entity's promise. This includes evaluating any clawbacks or other potential adjustments to the variable payment. For example, an entity may conclude that the nature of its promise in a contract is to provide hotel management services (including management of the hotel employees, accounting services, training, and procurement, etc.) that comprise a series of distinct services (i.e., daily hotel management). For providing this service, the entity receives a variable fee based on a percentage of occupancy rates. It is likely that the entity would determine that it meets the first criterion to allocate the daily variable fee to the distinct service performed that day because the uncertainty related to the consideration is resolved on a daily basis as the entity satisfies its obligation to perform daily hotel management services. This is because the variable payments specifically relate to transferring the distinct service that is part of a series of distinct goods or services (i.e., the daily management service). The fact that the payments do not directly correlate with each of the underlying activities performed each day does not affect this assessment. Refer to section 4 for further discussion on identifying the nature of the goods or services promised in a contract, including whether they meet the series requirement.

In contrast, consider an entity that has a contract to sell equipment and maintenance services for that equipment. The maintenance services have been determined to be a series of distinct services because the customer benefits from the entity standing ready to perform in case the equipment breaks down. The consideration for the maintenance services is based on usage of the equipment and is, therefore, variable. In this example, the payment terms do not align with the nature of the entity's promise. This is because the payment terms are usage-based, but the nature of the entity's promise is to stand ready each day to perform any maintenance that may be needed, regardless of how much the customer uses the equipment. Since the entity does not meet the criteria to apply the allocation exception, it must estimate the variable consideration over the life of the contract, including consideration of the constraint. The entity would then recognise revenue based on its selected measure of progress (see section 7.1.4).

After assessment of the first criterion, entities need to determine whether they meet the second criterion in IFRS 15.85; to confirm that allocating the consideration in this manner is consistent with the overall allocation objective

of the standard in IFRS 15.73. That is, an entity should allocate to each performance obligation (or distinct good or service in a series) the portion of the transaction price that reflects the amount of consideration the entity expects to be entitled in exchange for transferring those goods or services to the customer.

The TRG discussed four types of contracts with different variable payment terms that may be accounted for as series of distinct goods or services (see section 4.2.2) and for which an entity may reasonably conclude that the allocation objective has been met (and the variable consideration could be allocated to each distinct period of service, such as day, month or year), which are detailed below:[247]

- Declining prices – The TRG agenda paper included an IT outsourcing contract in which the events that trigger the variable consideration are the same throughout the contract, but the per unit price declines over the life of the contract. The allocation objective could be met if the pricing is based on market terms (e.g., if the contract contains a benchmarking clause) or the changes in price are substantive and linked to changes in an entity's cost to fulfil the obligation or value provided to the customer.
- Consistent fixed prices – The TRG agenda paper included a transaction processing contract with an unknown quantity of transactions, but a fixed contractual rate per transaction. The allocation objective could be met if the fees are priced consistently throughout the contract and the rates charged are consistent with the entity's standard pricing practices with similar customers.
- Consistent variable fees, cost reimbursements and incentive fees – The TRG agenda paper included a hotel management contract in which monthly consideration is based on a percentage of monthly rental revenue, reimbursement of labour costs and an annual incentive payment. The allocation objective could be met for each payment stream as follows. The base monthly fees could meet the allocation objective if the consistent measure throughout the contract period (e.g., 1% of monthly rental revenue) reflects the value to the customer. The cost reimbursements could meet the allocation objective if they are commensurate with an entity's efforts to fulfil the promise each day. The annual incentive fee could also meet the allocation objective if it reflects the value delivered to the customer for the annual period and is reasonable compared with incentive fees that could be earned in other periods.
- Sales-based and usage-based royalty for licences of intellectual property – The TRG agenda paper included a franchise agreement in which franchisor will receive a sales-based royalty of 5% in addition to a fixed fee. The allocation objective could be met if the consistent formula throughout the licence period reasonably reflects the value to the customer of its access to the franchisor's intellectual property (e.g., reflected by the sales that have been generated by the customer).

Beyond these four types of contracts discussed by the TRG, entities may also need to use judgement to determine whether contracts with usage-based variable consideration provisions meet the variable consideration allocation exception criteria, as follows:

[247] TRG Agenda paper no. 39, *Application of the Series Provision and Allocation of Variable Consideration*, dated 13 July 2015.

Variable fee arrangements based on usage

Consideration for some service contracts is based entirely on customer usage, and an entity has a stand-ready obligation to perform, regardless of how often the customer uses the service. Therefore, the usage-based fees are variable consideration.

It is important to note that, while these usage-based transactions may be economically similar to licensing arrangements that include sales-based or usage-based royalties, the accounting may be different. As described in section 8.5, sales-based and usage-based royalties on licences of intellectual property are subject to the royalty recognition constraint and that requirement must be applied to the overall royalty stream when the sole or predominant item to which the royalty relates is a licence of intellectual property. Entities cannot analogise to the royalty recognition constraint for other situations.

If the usage-based fees relate specifically to the entity's effort to satisfy the performance obligation to provide services (or to a specific outcome from satisfying the performance obligation) and allocating the variable consideration to each distinct day is consistent with the allocation objective, the variable consideration allocation exception is met and the consideration is allocated to the period in which the usage occurred. If the usage-based fees do not relate to an entity's effort to satisfy the performance obligation (or to a specific outcome from satisfying the performance obligation) or if the allocation of the usage-based fees is not consistent with the allocation exception, the allocation exception is not met. For example, the allocation exception would not be met if the fees decline over the contract term as an incentive for the customer to achieve certain volume thresholds if, as discussed above, such pricing is not based on market terms or not linked to changes in the entity's cost to fulfil the obligation or value provided to the customer. In this situation, the variable consideration is estimated at contract inception and it is to be recognised over the contract duration. These estimates of variable consideration must be updated at the end of each reporting period and are subject to the constraint on variable consideration. See section 5.2 for further discussion on estimating variable consideration.

Consider the following example of a contract with variable usage-based fees calculated daily that is likely to meet the variable consideration allocation exception:

Illustration 6-5 — Variable fee service arrangement based on usage

Provider C enters into a contract for cloud storage in which a customer agrees to pay daily fees based on the amount of storage space it uses (i.e., a fixed daily rate of CU0.025 per gigabyte of storage is multiplied by the number of gigabytes used). Provider C invoices the customer at the end of each month. Assume that the entity has appropriately concluded that the nature of the entity's performance obligation is to stand ready to provide any amount of storage space the customer needs at any time during the contract term and the consideration in the contract is variable based on the number of gigabytes of storage used (and, therefore, each gigabyte used is not an optional purchase – refer to Question 4-17).

Provider C determines that the service provided to the customer in this contract meets the criteria to be accounted for as a series of distinct goods or services (see section 4.2.2). This is because the performance obligation to stand ready to provide any amount of storage space represents a series of distinct services that are substantially the same and have the same pattern of transfer to the customer.

Illustration 6-5 — Variable fee service arrangement based on usage (cont'd)

Provider C then considers whether the variable consideration allocation exception would apply to the daily usage-based fees. Provider C determines that it meets the first criterion to allocate the daily variable fee to the distinct service performed that day because the uncertainty related to the consideration is resolved on a daily basis as the entity satisfies its obligation to provide cloud storage. This is because the variable payments specifically relate to transferring the distinct service: access to any amount of cloud storage that the customer chooses to use each day.

Provider C concludes that allocating the variable payments to each day is consistent with the allocation objective because the fixed-rate-per-gigabyte fees reflect the value to the customer based on the amount of storage the customer uses each day. Further, the rates charged are consistent with Provider C's standard pricing practices.

Therefore, Provider C determines that it needs to apply the variable consideration allocation exception and recognises each day's fee for the day in which it occurs. That is, if the customer uses 250 gigabytes of storage the first day and 300 gigabytes the second, Provider C will recognise CU6.25 and CU7.50 of revenue for the respective days.

Fixed-fee arrangements with overages

Some service contracts may have fixed fees (including any minimum amounts guaranteed) but also require customers to pay overage fees when they exceed certain thresholds based on usage. When an entity's performance obligation is to stand ready to perform, regardless of customer usage, the overage fee is considered variable consideration that the entity needs to estimate at contract inception, unless the variable consideration allocation exception is met.

Consider the following example of a contract with fixed fees and annual overages:

Illustration 6-6 — Fixed-fee service arrangement with overages

Entity X enters into a three-year contract with a customer to provide access to its SaaS application, which allows the customer to process transactions, among other functions. The customer agrees to pay an annual fee of CU100,000, plus overage fees at a rate of CU0.10 per transaction for transactions processed through the application during the year that exceed one million (i.e., overage fees are only paid if the customer processes more than one million transactions during the year).

Assume that Entity X has determined that the nature of its performance obligation is to provide continuous access to the SaaS application, regardless of the number of transactions processed. Entity X determines that the CU100,000 annual fee is fixed consideration and all additional consideration received as overage fees is variable consideration.

Also assume that Entity X has determined that the fixed component of the consideration should be recognised rateably over the contract term because the service is provided to the customer on a consistent basis (i.e., the performance obligation is satisfied evenly over the period). Entity X will then need to determine whether the variable consideration allocation exception applies to the overage fees, which are calculated based on annual usage.

Illustration 6-6 — Fixed-fee service arrangement with overages (cont'd)

Evaluating the allocation exception for distinct daily periods

We believe that, for the entity to apply the variable consideration allocation exception by allocating overage fees to a particular day, the entity would have to conclude that the overage fees relate to its performance on that particular day. Therefore, Entity X may conclude that it cannot apply the variable consideration allocation exception to the daily reporting periods for the overage fees because those payments do not relate to its efforts to satisfy the performance obligation to provide continuous access to the platform. That is, the nature of the performance obligation is a series of daily stand-ready obligations that are satisfied evenly over time, and the overage fees are additional consideration for satisfying that performance obligation over the course of each year.

Since the overage fees are only incurred after the annual minimum is reached, recognising revenue when the fees are incurred would result in more revenue recognised for the periods after the minimum is reached (i.e., backloading the revenue recognition), which is inconsistent with the allocation objective in IFRS 15.73. Therefore, the criteria for using the variable consideration allocation exception would not be met for each day of service, and Entity X would not recognise revenue for the overages on the days when the fees are incurred. However, we believe that if the overages in this example were calculated based on a short period of usage (e.g., daily or monthly (instead of annually)), Entity X may be able to demonstrate that it meets the criteria to apply the variable consideration allocation exception. This is because of the relatively short period of time between Entity X's performance and when it is entitled to the variable consideration such that Entity X could reasonably conclude that the allocation objective in IFRS 15.73 has been met.

Evaluating the allocation exception for annual periods

Since Entity X earns overage fees over a period of time that is less than the contract term (i.e., a three-year contract where overage fees are accrued and reset on an annual basis), Entity X would evaluate whether the overages need to be allocated to the period in which the overage fees are earned (e.g., to the annual period in which overages accrue).

To do so, Entity X evaluates whether it meets the criteria to apply the variable consideration allocation exception to the overage fees earned in each annual period in the three-year contract. Entity X may conclude that it needs to apply the variable consideration allocation exception to the overage fees earned in annual periods, which would require the entity to allocate the annual overage fees to each respective year (since the overages can be attributed to a single year). Therefore, Entity X will need to estimate overage fees only for each annual period (also considering the variable consideration constraint, as discussed in section 5.2), rather than for the full three-year period at contract inception (which would be required if the variable consideration allocation exception was not met for any period). This would result in recognition of revenue from the overage fees only in the annual period to which the overages relate and not over the entire contract term.

For example, if the entity estimated that the overage fees for the first year would be CU20,000, it would recognise this amount rateably over the year (i.e., CU5,000 in each quarter), in addition to the fixed consideration that is also recognised rateably. The estimates of variable consideration must be updated at the end of each reporting period, as discussed in section 5.2.4.

Illustrative example

The standard provides the following example to illustrate when an entity may or may not be able to allocate variable consideration to a specific part of a contract. Note that the example focuses on licences of intellectual property, which are discussed in section 8:

Extract from IFRS 15

Example 35 — Allocation of variable consideration (IFRS 15.IE178-IE187)

An entity enters into a contract with a customer for two intellectual property licences (Licences X and Y), which the entity determines to represent two performance obligations each satisfied at a point in time. The stand-alone selling prices of Licences X and Y are CU800 and CU1,000, respectively.

Case A—Variable consideration allocated entirely to one performance obligation

The price stated in the contract for Licence X is a fixed amount of CU800 and for Licence Y the consideration is three per cent of the customer's future sales of products that use Licence Y. For purposes of allocation, the entity estimates its sales-based royalties (ie the variable consideration) to be CU1,000, in accordance with paragraph 53 of IFRS 15.

To allocate the transaction price, the entity considers the criteria in paragraph 85 of IFRS 15 and concludes that the variable consideration (ie the sales-based royalties) should be allocated entirely to Licence Y. The entity concludes that the criteria in paragraph 85 of IFRS 15 are met for the following reasons:

(a) The variable payment relates specifically to an outcome from the performance obligation to transfer Licence Y (ie the customer's subsequent sales of products that use Licence Y).

(b) Allocating the expected royalty amounts of CU1,000 entirely to Licence Y is consistent with the allocation objective in paragraph 73 of IFRS 15. This is because the entity's estimate of the amount of sales-based royalties (CU1,000) approximates the stand-alone selling price of Licence Y and the fixed amount of CU800 approximates the stand-alone selling price of Licence X. The entity allocates CU800 to Licence X in accordance with paragraph 86 of IFRS 15. This is because, based on an assessment of the facts and circumstances relating to both licences, allocating to Licence Y some of the fixed consideration in addition to all of the variable consideration would not meet the allocation objective in paragraph 73 of IFRS 15.

The entity transfers Licence Y at inception of the contract and transfers Licence X one month later. Upon the transfer of Licence Y, the entity does not recognise revenue because the consideration allocated to Licence Y is in the form of a sales-based royalty. Therefore, in accordance with paragraph B63 of IFRS 15, the entity recognises revenue for the sales-based royalty when those subsequent sales occur.

When Licence X is transferred, the entity recognises as revenue the CU800 allocated to Licence X.

Extract from IFRS 15 (cont'd)

Case B—Variable consideration allocated on the basis of stand-alone selling prices

The price stated in the contract for Licence X is a fixed amount of CU300 and for Licence Y the consideration is five per cent of the customer's future sales of products that use Licence Y. The entity's estimate of the sales-based royalties (ie the variable consideration) is CU1,500 in accordance with paragraph 53 of IFRS 15.

To allocate the transaction price, the entity applies the criteria in paragraph 85 of IFRS 15 to determine whether to allocate the variable consideration (ie the sales-based royalties) entirely to Licence Y. In applying the criteria, the entity concludes that even though the variable payments relate specifically to an outcome from the performance obligation to transfer Licence Y (ie the customer's subsequent sales of products that use Licence Y), allocating the variable consideration entirely to Licence Y would be inconsistent with the principle for allocating the transaction price. Allocating CU300 to Licence X and CU1,500 to Licence Y does not reflect a reasonable allocation of the transaction price on the basis of the stand-alone selling prices of Licences X and Y of CU800 and CU1,000, respectively. Consequently, the entity applies the general allocation requirements in paragraphs 76–80 of IFRS 15.

The entity allocates the transaction price of CU300 to Licences X and Y on the basis of relative stand-alone selling prices of CU800 and CU1,000, respectively. The entity also allocates the consideration related to the sales-based royalty on a relative stand-alone selling price basis. However, in accordance with paragraph B63 of IFRS 15, when an entity licenses intellectual property in which the consideration is in the form of a sales-based royalty, the entity cannot recognise revenue until the later of the following events: the subsequent sales occur or the performance obligation is satisfied (or partially satisfied).

Licence Y is transferred to the customer at the inception of the contract and Licence X is transferred three months later. When Licence Y is transferred, the entity recognises as revenue the CU167 (CU1,000 ÷ CU1,800 × CU300) allocated to Licence Y. When Licence X is transferred, the entity recognises as revenue the CU133 (CU800 ÷ CU1,800 × CU300) allocated to Licence X.

In the first month, the royalty due from the customer's first month of sales is CU200. Consequently, in accordance with paragraph B63 of IFRS 15, the entity recognises as revenue the CU111 (CU1,000 ÷ CU1,800 × CU200) allocated to Licence Y (which has been transferred to the customer and is therefore a satisfied performance obligation). The entity recognises a contract liability for the CU89 (CU800 ÷ CU1,800 × CU200) allocated to Licence X. This is because although the subsequent sale by the entity's customer has occurred, the performance obligation to which the royalty has been allocated has not been satisfied.

Frequently asked questions

Question 6-8: In order to meet the criteria to allocate variable consideration entirely to a specific part of a contract, must the allocation be made on a relative stand-alone selling price basis? [TRG meeting 13 July 2015 – Agenda paper no. 39]

No. TRG members generally agreed that a relative stand-alone selling price allocation is not required to meet the allocation objective when it relates to the allocation of variable consideration to a specific part of a contract (e.g., a distinct good or service in a series). The Basis for Conclusions notes that stand-alone selling price is the default method for meeting the allocation objective, but other methods could be used in certain instances (e.g., in allocating variable consideration).[248]

Stakeholders had questioned whether the variable consideration exception would have limited application to a series of distinct goods or services (see section 4.2.2). That is, they wanted to know whether the standard would require that each distinct service that is substantially the same be allocated the same amount (absolute value) of variable consideration. While the standard does not state what other allocation methods could be used beyond the relative stand-alone selling price basis, TRG members generally agreed that an entity would apply reasonable judgement to determine whether the allocation results in a reasonable outcome (and, therefore, meets the allocation objective in the standard), as discussed above in section 6.3.

6.4 Allocating a discount

The second exception to the relative stand-alone selling price allocation (see section 6.3 for the first exception) relates to discounts inherent in contracts. When an entity sells a bundle of goods or services, the selling price of the bundle is often less than the sum of the stand-alone selling prices of the individual elements. Under the relative stand-alone selling price allocation method, this discount would be allocated proportionately to all performance obligations. However, if an entity determines that a discount is not related to all of the promised goods or services in the contract, the entity must allocate the contract's entire discount only to the goods or services to which it relates, if all of the following criteria are met:

Extract from IFRS 15

82. An entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:

(a) the entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis;

(b) the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle; and

(c) the discount attributable to each bundle of goods or services described in paragraph 82(b) is substantially the same as the discount in the contract and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation (or performance obligations) to which the entire discount in the contract belongs.

[248] IFRS 15.BC279-BC280.

An entity makes this determination when the price of certain goods or services is largely independent of other goods or services in the contract. In these situations, an entity is able to effectively 'carve out' an individual performance obligation, or some of the performance obligations in the contract, and allocate the contract's entire discount to one or more, but not all, performance obligations provided the above criteria are met. However, an entity cannot use this exception to allocate only a portion of the discount to one or more, but not all, performance obligations in the contract.

The Board noted in the Basis for Conclusions that the requirements in IFRS 15.82 generally apply to contracts that include at least three performance obligations. While the standard contemplates that an entity may allocate the entire discount to as few as one performance obligation, the Board noted that such situations are expected to be rare.[249] Instead, the Board believes it is more likely that an entity will be able to demonstrate that a discount relates to two or more performance obligations. This is because an entity is likely to have observable information that the stand-alone selling price of a group of promised goods or services is lower than the price of those items when sold separately. It may be more difficult for an entity to have sufficient evidence to demonstrate that a discount is associated with a single performance obligation. When an entity applies a discount to one or more performance obligations in accordance with the above criteria, the standard states that the discount is allocated first before using the residual approach to estimate the stand-alone selling price of a good or service (see section 6.1.2).[250]

The standard includes the following example to illustrate this exception and when the use of the residual approach for estimating stand-alone selling prices may or may not be appropriate:

Extract from IFRS 15

Example 34 — Allocating a discount (IFRS 15.IE167-IE177)

An entity regularly sells Products A, B and C individually, thereby establishing the following stand-alone selling prices:

Product	Stand-alone selling price
	CU
Product A	40
Product B	55
Product C	45
Total	140

In addition, the entity regularly sells Products B and C together for CU60.

Case A—Allocating a discount to one or more performance obligations

The entity enters into a contract with a customer to sell Products A, B and C in exchange for CU100. The entity will satisfy the performance obligations for each of the products at different points in time.

[249] IFRS 15.BC283.
[250] IFRS 15.83.

Extract from IFRS 15 (cont'd)

The contract includes a discount of CU40 on the overall transaction, which would be allocated proportionately to all three performance obligations when allocating the transaction price using the relative stand-alone selling price method (in accordance with paragraph 81 of IFRS 15). However, because the entity regularly sells Products B and C together for CU60 and Product A for CU40, it has evidence that the entire discount should be allocated to the promises to transfer Products B and C in accordance with paragraph 82 of IFRS 15.

If the entity transfers control of Products B and C at the same point in time, then the entity could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, the entity could allocate CU60 of the transaction price to the single performance obligation and recognise revenue of CU60 when Products B and C simultaneously transfer to the customer.

If the contract requires the entity to transfer control of Products B and C at different points in time, then the allocated amount of CU60 is individually allocated to the promises to transfer Product B (stand-alone selling price of CU55) and Product C (stand-alone selling price of CU45) as follows:

Product	Allocated transaction price	
	CU	
Product B	33	(CU55 ÷ CU100 total stand-alone selling price × CU60)
Product C	27	(CU45 ÷ CU100 total stand-alone selling price × CU60)
Total	60	

Case B—Residual approach is appropriate

The entity enters into a contract with a customer to sell Products A, B and C as described in Case A. The contract also includes a promise to transfer Product D. Total consideration in the contract is CU130. The stand-alone selling price for Product D is highly variable (see paragraph 79(c) of IFRS 15) because the entity sells Product D to different customers for a broad range of amounts (CU15–CU45). Consequently, the entity decides to estimate the stand-alone selling price of Product D using the residual approach.

Before estimating the stand-alone selling price of Product D using the residual approach, the entity determines whether any discount should be allocated to the other performance obligations in the contract in accordance with paragraphs 82 and 83 of IFRS 15.

As in Case A, because the entity regularly sells Products B and C together for CU60 and Product A for CU40, it has observable evidence that CU100 should be allocated to those three products and a CU40 discount should be allocated to the promises to transfer Products B and C in accordance with paragraph 82 of IFRS 15. Using the residual approach, the entity estimates

Extract from IFRS 15 (cont'd)

the stand-alone selling price of Product D to be CU30 as follows:

Product	Stand-alone selling price	Method
	CU	
Product A	40	Directly observable (see paragraph 77 of IFRS 15)
Products B and C	60	Directly observable with discount (see paragraph 82 of IFRS 15)
Product D	30	Residual approach (see paragraph 79(c) of IFRS 15)
Total	130	

The entity observes that the resulting CU30 allocated to Product D is within the range of its observable selling prices (CU15–CU45). Therefore, the resulting allocation (see above table) is consistent with the allocation objective in paragraph 73 of IFRS 15 and the requirements in paragraph 78 of IFRS 15.

Case C—Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is CU105 instead of CU130. Consequently, the application of the residual approach would result in a stand-alone selling price of CU5 for Product D (CU105 transaction price less CU100 allocated to Products A, B and C). The entity concludes that CU5 would not faithfully depict the amount of consideration to which the entity expects to be entitled in exchange for satisfying its performance obligation to transfer Product D, because CU5 does not approximate the stand-alone selling price of Product D, which ranges from CU15–CU45. Consequently, the entity reviews its observable data, including sales and margin reports, to estimate the stand-alone selling price of Product D using another suitable method. The entity allocates the transaction price of CU105 to Products A, B, C and D using the relative stand-alone selling prices of those products in accordance with paragraphs 73–80 of IFRS 15.

How we see it

The exception allowing allocation of a discount to some, but not all, performance obligations within a contract gives entities the ability to better reflect the economics of the transaction in certain circumstances. However, the criteria that must be met to demonstrate that a discount is associated with only some of the performance obligations in the contract is likely to limit the number of transactions that are eligible for this exception.

Frequently asked questions

Question 6-9: If a discount also meets the definition of variable consideration (because it is variable in amount and/or contingent on a future event), which allocation exception would an entity apply? [TRG meeting 30 March 2015 – Agenda paper no. 31]

TRG members generally agreed that an entity will first determine whether a variable discount meets the variable consideration exception (see section 6.3 above).[251] If it does not, the entity then considers whether it meets the discount exception (see section 6.4 above). In reaching that conclusion, the TRG agenda paper noted that IFRS 15.86 establishes a hierarchy for allocating variable consideration that requires an entity to identify variable consideration and then determine whether it should allocate variable consideration to one or some, but not all, performance obligations (or distinct goods or services that comprise a single performance obligation) based on the exception for allocating variable consideration. The entity would consider the requirements for allocating a discount only if the discount is not variable consideration (i.e., the amount of the discount is fixed and not contingent on future events) or the entity does not meet the criteria to allocate variable consideration to a specific part of the contract.

6.5 Changes in transaction price after contract inception (updated October 2020)

The standard requires entities to determine the transaction price at contract inception. However, there could be changes to the transaction price after contract inception. For example, as discussed in section 5.2.4, when a contract includes variable consideration, entities need to update their estimate of the transaction price at the end of each reporting period to reflect any changes in circumstances. Changes in the transaction price can also occur due to contract modifications (see section 3.4).

As stated in IFRS 15.88-89, changes in the total transaction price are generally allocated to the performance obligations on the same basis as the initial allocation, whether they are allocated based on the relative stand-alone selling price (i.e., using the same proportionate share of the total) or to individual performance obligations under the variable consideration exception discussed in section 6.3. Amounts allocated to a satisfied performance obligation should be recognised as revenue, or a reduction in revenue, in the period that the transaction price changes.

As discussed in section 6.1, stand-alone selling prices are not updated after contract inception, unless the contract has been modified. Furthermore, any amounts allocated to satisfied (or partially satisfied) performance obligations should be recognised in revenue in the period in which the transaction price changes (i.e., on a cumulative catch-up basis). This could result in either an increase or decrease to revenue in relation to a satisfied performance obligation or to cumulative revenue recognised for a partially satisfied over time performance obligation (see section 7.1).

[251] IFRS 15.86.

The following example illustrates this concept for a partially satisfied over-time performance obligation:

Illustration 6-7 — Change in transaction price after contract inception

Entity A, a construction company, enters into a contract with a customer on 1 January 20X1 to build three specific amenities at a community centre, a swimming pool, playground and a parking lot, for CU3,000,000. Entity A will earn a bonus of CU250,000 if it completes the swimming pool by 1 May 20X1.

At contract inception, Entity A concludes that the swimming pool, playground and parking lot are each distinct and, therefore, represent separate performance obligations. Entity A also concludes that the CU250,000 bonus needs to be allocated entirely to the swimming pool because the criteria in IFRS 15.85 for the variable consideration allocation are met. However, Entity A does not expect it will be entitled to the CU250,000 bonus related to the completion of the swimming pool by 1 May 20X1 due to factors outside of Entity A's control, including inclement winter weather and the swimming pool supplier's backlog. Therefore, Entity A uses the most likely amount method to estimate variable consideration and does not include the bonus in the transaction price.

As at 1 January 20X1, Entity A allocates the transaction price to the performance obligations on a relative stand-alone selling price basis, as follows:

Performance obligations	Allocation of the transaction price
Swimming pool	CU2,000,000
Playground	CU750,000
Parking lot	CU250,000
Total	CU3,000,000

Entity A concludes that each of the performance obligations are satisfied over time because they meet the criteria in IFRS 15.35 (refer to section 7.1 for further discussion on evaluating whether performance obligations are satisfied over time). Due to the nature of Entity A's business, it determines that an input method based on costs incurred is an appropriate measure of progress over time.

As at 31 March 20X1, Entity A determines that it has incurred 60% of the total expected costs to complete each of its performance obligations. Therefore, Entity A recognises CU1,800,000 (CU3,000,000 x 60%) as revenue.

Illustration 6-7 — Change in transaction price after contract inception (cont'd)

In addition, as at 31 March 20X1, Entity A reassesses its estimate of variable consideration in the contract (including the constraint) and believes it will be able to complete the swimming pool by 1 May 20X1, because the significant uncertainties related to the weather and the supplier have been resolved. Entity A updates its transaction price to include the CU250,000 bonus related to the swimming pool in accordance with IFRS 15.59. Therefore, Entity A updates the transaction price as at 31 March 20X1, as follows:

Performance obligations	Allocation of the transaction price
Swimming pool	CU2,250,000
Playground	CU750,000
Parking lot	CU250,000
Total	CU3,250,000

Due to the change in the transaction price related to the swimming pool performance obligation, Entity A recognises CU150,000 (CU250,000 x 60%) as revenue on a cumulative catch-up basis as at 31 March 20X1.

If the change in the transaction price is due to a contract modification, the contract modification requirements in IFRS 15.18-21 must be followed (see section 3.4 for a discussion on contract modifications). However, when contracts include variable consideration, it is possible that changes in the transaction price that arise after a modification may (or may not) be related to performance obligations that existed before the modification. For changes in the transaction price arising after a contract modification that is not treated as a separate contract, an entity must apply one of the two approaches:

- If the change in transaction price is attributable to an amount of variable consideration promised before the modification and the modification was considered a termination of the existing contract and the creation of a new contract, the entity allocates the change in transaction price to the performance obligations that existed before the modification.
- In all other cases, the change in the transaction price is allocated to the performance obligations in the modified contract (i.e., the performance obligations that were unsatisfied and partially unsatisfied immediately after the modification).

The first approach is applicable to a change in transaction price that occurs after a contract modification that is accounted for in accordance with IFRS 15.21(a) (i.e., as a termination of the existing contract and the creation of a new contract) and the change in the transaction price is attributable to variable consideration promised before the modification. For example, an estimate of variable consideration in the initial contract may have changed or may no longer be constrained. In this scenario, the Board decided that an entity should allocate the corresponding change in the transaction price to the performance obligations identified in the contract before the modification (e.g., the original contract), including performance obligations that were satisfied prior to the modification.[252] That is, it would not be appropriate for an entity to allocate the corresponding change in the transaction price to the performance obligations that are in the modified contract if the promised

[252] IFRS 15.BC83.

variable consideration (and the resolution of the associated uncertainty) were not affected by the contract modification.

The second approach (i.e., IFRS 15.90(b)) is applicable in all other cases when a modification is not treated as a separate contract (e.g., when the change in the transaction price is not attributable to variable consideration promised before the modification).

The IASB noted in the Basis for Conclusions on IFRS 15 that in some cases, an estimate of variable consideration made at the end of a reporting period could be affected by information that arises after the end of the reporting period, but before the release of the financial statements. The Board decided not to include guidance in IFRS 15 to address this circumstance because an entity would follow the accounting requirements for subsequent events in IAS 10.[253]

6.6 Allocation of transaction price to components outside the scope of IFRS 15 (updated October 2018)

Revenue arrangements may include some components that are not within the scope of IFRS 15. As discussed in section 2.5, the standard indicates that in such situations, an entity must first apply the other standards if those standards address separation and/or measurement.

For example, some standards require certain components, such as financial liabilities, to be accounted for at fair value. As a result, when a revenue contract includes that type of component, the fair value of that component must be separated from the total transaction price. The remaining transaction price is then allocated to the remaining performance obligations.

The following example illustrates this concept:

Illustration 6-8 — Arrangements with components outside the scope of the standard

Retailer sells products to customers and often bundles them with prepaid gift cards when the customer buys multiple units of its products. The prepaid gift cards are non-refundable, non-redeemable and non-exchangeable for cash and do not have an expiry date or back-end fees. That is, any remaining balance on the prepaid gift cards does not reduce, unless it is spent by the customer. Customers can redeem prepaid gift cards only at third-party merchants specified by Retailer (i.e., the prepaid gift card cannot be redeemed at the Retailer) in exchange for goods or services up to a specified monetary amount. When a customer uses the prepaid gift cards at a merchant(s) to purchase goods or services, Retailer delivers cash to the merchant(s).

Customer X enters into a contract to purchase 100 units of a product and a prepaid gift card for total consideration of CU1,000. Because it bought 100 units, Retailer gives Customer X a discount on the bundle. The stand-alone selling price of the product and the fair value of the prepaid gift card are CU950 and CU200, respectively.

[253] IFRS 15.BC228.

Illustration 6-8 — Arrangements with components outside the scope of the standard (cont'd)

Retailer determines that it has a contractual obligation to deliver cash to specified merchants on behalf of the prepaid gift card owner (Customer X) and that this obligation is conditional upon Customer X using the prepaid gift card to purchase goods or services. Also, Retailer does not have an unconditional right to avoid delivering cash to settle this contractual obligation. Therefore, Retailer concludes that the liability for the prepaid gift card meets the definition of a financial liability and applies the requirements in IFRS 9 to account for it. In accordance with IFRS 15.7, because IFRS 9 provides measurement requirements for initial recognition (i.e., requires that financial liabilities within its scope be initially recognised at fair value), Retailer excludes from the IFRS 15 transaction price the fair value of the prepaid gift card. Retailer allocates the remaining transaction price to the products purchased. The allocation of the total transaction price is, as follows:

	stand-alone selling price and fair value	% Allocated discount	Allocated discount	Arrangement consideration allocation
Products (100 units)	CU950	100%	CU150	C800
Prepaid gift card	CU200	0%	–	CU200
	CU1,1150		CU150	CU1,000

For components that must be recognised at fair value at inception, any subsequent remeasurement would be pursuant to other IFRSs (e.g., IFRS 9). That is, subsequent adjustments to the fair value of those components have no effect on the amount of the transaction price previously allocated to any performance obligations included within the contract or on revenue recognised.

7. Satisfaction of performance obligations

Under IFRS 15, an entity only recognises revenue when it satisfies an identified performance obligation by transferring a promised good or service to a customer. A good or service is considered to be transferred when the customer obtains control.[254]

IFRS 15 states that "control of an asset refers to the ability to direct the use of and obtain substantially all of the remaining benefits from the asset".[255] Control also means the ability to prevent others from directing the use of, and receiving the benefit from, a good or service. The Board noted that both goods and services are assets that a customer acquires (even if many services are not recognised as an asset because those services are simultaneously received and consumed by the customer).[256] The IASB explained the key terms in the definition of control in the Basis for Conclusions, which are, as follows:[257]

- *Ability* — a customer must have the present right to direct the use of, and obtain substantially all of the remaining benefits from, an asset for an entity to recognise revenue. For example, in a contract that requires a manufacturer to produce an asset for a customer, it might be clear that the customer will ultimately have the right to direct the use of, and obtain substantially all of the remaining benefits from, the asset. However, the entity should not recognise revenue until the customer has actually obtained that right (which, depending on the contract, may occur during production or afterwards).
- *Direct the use of* — a customer's ability to direct the use of an asset refers to the customer's right to deploy or to allow another entity to deploy that asset in its activities or to restrict another entity from deploying that asset.
- *Obtain the benefits from* — the customer must have the ability to obtain substantially all of the remaining benefits from an asset for the customer to obtain control of it. Conceptually, the benefits from a good or service are potential cash flows (either an increase in cash inflows or a decrease in cash outflows). IFRS 15.33 indicates that a customer can obtain the benefits directly or indirectly in many ways, such as: using the asset to produce goods or services (including public services); using the asset to enhance the value of other assets; using the asset to settle a liability or reduce an expense; selling or exchanging the asset; pledging the asset to secure a loan; or holding the asset.

Under IFRS 15, the transfer of control to the customer represents the transfer of the rights with regard to the good or service. The customer's ability to receive the benefit from the good or service is represented by its right to substantially all of the cash inflows, or the reduction of the cash outflows, generated by the goods or services. Upon transfer of control, the customer has sole possession of the right to use the good or service for the remainder of its economic life or to consume the good or service in its own operations.

[254] IFRS 15.31.
[255] IFRS 15.33.
[256] IFRS 15.BC118.
[257] IFRS 15.BC120.

The IASB explained in the Basis for Conclusions that control should be assessed primarily from the customer's perspective. While a seller often surrenders control at the same time the customer obtains control, the Board required the assessment of control to be from the customer's perspective to minimise the risk of an entity recognising revenue from activities that do not coincide with the transfer of goods or services to the customer.[258]

The standard indicates that an entity must determine, at contract inception, whether it will transfer control of a promised good or service over time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.[259] These concepts are explored further in the following sections.

7.1 Performance obligations satisfied over time (updated September 2019)

Frequently, entities transfer the promised goods or services to the customer over time. While the determination of whether goods or services are transferred over time is straightforward in some contracts (e.g., many service contracts), it is more difficult in other contracts.

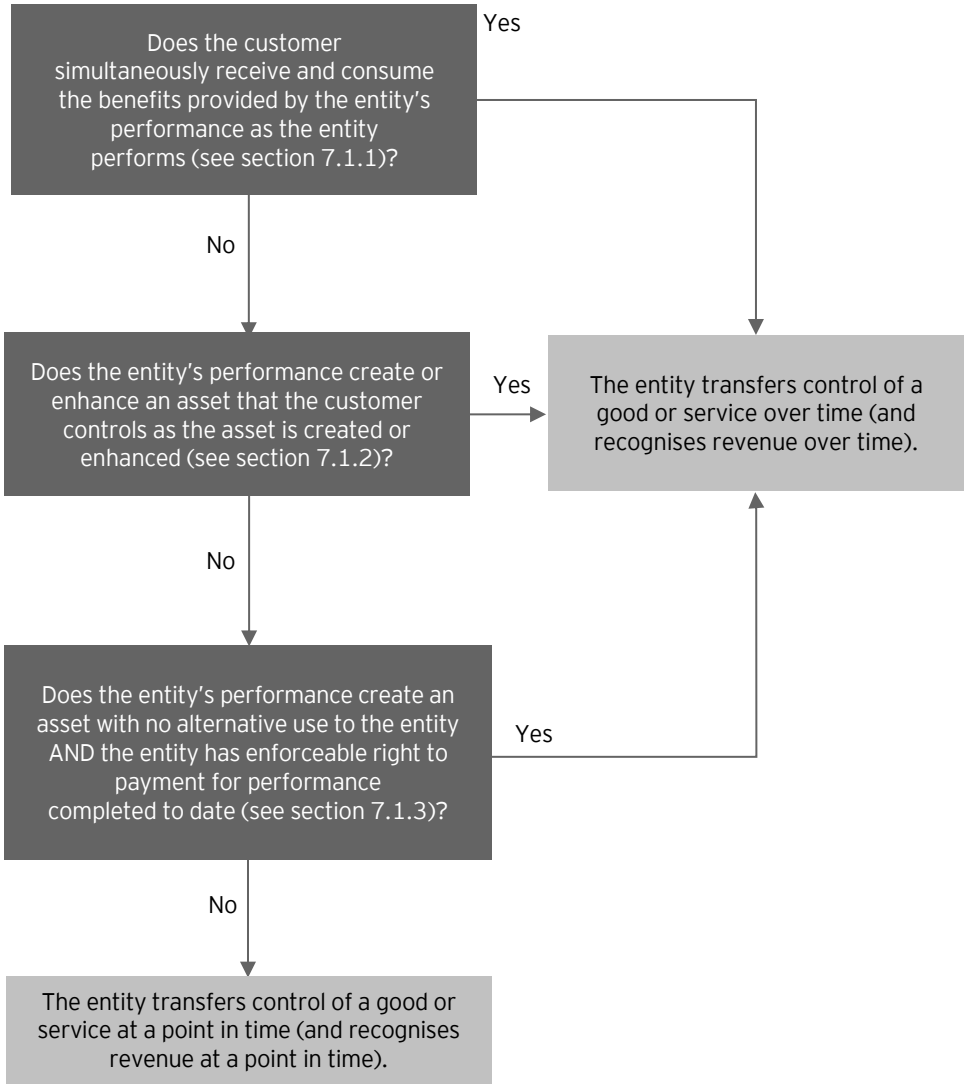
IFRS 15.35 states that an entity transfers control of a good or service over time if one of the following criteria is met:

- As the entity performs, the customer simultaneously receives and consumes the benefits provided by the entity's performance.
- The entity's performance creates or enhances an asset (e.g., work in progress) that the customer controls as the asset is created or enhanced.
- The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

Examples of each of the criteria above are included in the following sections. If an entity is unable to demonstrate that control transfers over time, the presumption is that control transfers at a point in time (see section 7.2).

[258] IFRS 15.BC121.
[259] IFRS 15.32.

The following flow chart illustrates how to evaluate whether control transfers over time:



How we see it

Determining when performance obligations are satisfied requires judgement. IFRS 15.119(a) requires an entity to disclose when it typically satisfies its performance obligations (e.g., upon shipment, as services are delivered). See section 10.5.1 for more information. IFRS 15.123(a) requires entities to disclose significant judgements made in determining the timing of satisfaction of performance obligations and IFRS 15.124 requires entities to disclose the method used to recognise revenue (e.g., a description of the input or output method used and how that method is applied) and why the method selected provides a faithful depiction of the transfer of goods or services. See section 10.5 for more information on these disclosure requirements. Entities should review their disclosures to verify that they not only meet the specific requirements of IFRS 15.119(a), 123(a) and 124, but they also meet the overall disclosure objective in IFRS 15.110.

Frequently asked questions

Question 7-1: Do all contracts with a stand-ready element include a single performance obligation that is satisfied over time? [TRG meeting 9 November 2015 – Agenda paper no. 48]

See response to Question 4-3 in section 4.1.1

7.1.1 Customer simultaneously receives and consumes benefits as the entity performs (updated September 2019)

As the Board explained in the Basis for Conclusions, in many service contracts the entity's performance creates an asset, momentarily, because that asset is simultaneously received and consumed by the customer. In these cases, the customer obtains control of the entity's output as the entity performs. Therefore, the performance obligation is satisfied over time.[260] While this criterion most often applies to service contracts, the TRG discussed instances in which commodity contracts (e.g., electricity, natural gas, heating oil) could be recognised over time. These situations could arise if the facts and circumstances of the contract indicate that the customer will simultaneously receive and consume the benefits (e.g., a continuous supply contract to meet immediate demands).[261] Refer to Question 7-2 for further information.

There may be contracts in which it is unclear whether the customer simultaneously receives and consumes the benefit of the entity's performance over time. To assist entities, IFRS 15 provides the following application guidance:

Extract from IFRS 15

B3. For some types of performance obligations, the assessment of whether a customer receives the benefits of an entity's performance as the entity performs and simultaneously consumes those benefits as they are received will be straightforward. Examples include routine or recurring services (such as a cleaning service) in which the receipt and simultaneous consumption by the customer of the benefits of the entity's performance can be readily identified.

B4. For other types of performance obligations, an entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In those circumstances, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date if that other entity were to fulfil the remaining performance obligation to the customer. In determining whether another entity would not need to substantially re-perform the work the entity has completed to date, an entity shall make both of the following assumptions:

(a) disregard potential contractual restrictions or practical limitations that otherwise would prevent the entity from transferring the remaining performance obligation to another entity; and

(b) presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any asset that is presently controlled by the entity and that would remain controlled by the entity if the performance obligation were to transfer to another entity.

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[260] IFRS 15.BC125.

[261] TRG Agenda paper no. 43, *Determining When Control of a Commodity Transfers*, dated 13 July 2015.

The IASB added this application guidance because the notion of 'benefit' can be subjective. As discussed in the Basis for Conclusions, the Board provided an example of a freight logistics contract. Assume that the entity has agreed to transport goods from Vancouver to New York City. Some stakeholders had suggested that the customer receives no benefit from the entity's performance until the goods are delivered to, in this case, New York City. However, the Board said that the customer benefits as the entity performs. This is because, if the goods were only delivered part of the way (e.g., to Chicago), another entity would not need to substantially re-perform the entity's performance to date. The Board observed that in these cases, the assessment of whether another entity would need to substantially re-perform the entity's performance to date is an objective way to assess whether the customer receives benefit from the entity's performance as it occurs.[262]

In assessing whether a customer simultaneously receives and consumes the benefits provided by an entity's performance, all relevant facts and circumstances need to be considered. This includes considering the inherent characteristics of the good or service, the contract terms and information about how the good or service is transferred or delivered. However, as noted in IFRS 15.B4(a), an entity disregards any contractual or practical restrictions when it assesses this criterion. In the Basis for Conclusions, the IASB explained that the assessment of whether control of the goods or services has transferred to the customer is performed by making a hypothetical assessment of what another entity would need to do if it were to take over the remaining performance. Therefore, actual practical or contractual restrictions would have no bearing on the assessment of whether the entity had already transferred control of the goods or services provided to date.[263]

The standard provides the following example that illustrates a customer simultaneously receiving and consuming the benefits as the entity performs in relation to a series of distinct payroll processing services:

Extract from IFRS 15

Example 13 — Customer simultaneously receives and consumes the benefits (IFRS 15.IE67-IE68)

An entity enters into a contract to provide monthly payroll processing services to a customer for one year.

The promised payroll processing services are accounted for as a single performance obligation in accordance with paragraph 22(b) of IFRS 15. The performance obligation is satisfied over time in accordance with paragraph 35(a) of IFRS 15 because the customer simultaneously receives and consumes the benefits of the entity's performance in processing each payroll transaction as and when each transaction is processed. The fact that another entity would not need to re-perform payroll processing services for the service that the entity has provided to date also demonstrates that the customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs. (The entity disregards any practical limitations on transferring the remaining performance obligation, including setup activities that would need to be undertaken by another entity.) The entity recognises revenue over time by measuring its progress towards complete satisfaction of that performance obligation in accordance with paragraphs 39–45 and B14–B19 of IFRS 15.

[262] IFRS 15.BC126.
[263] IFRS 15.BC127.

The IASB clarified, in the Basis for Conclusions, that an entity does not evaluate this criterion (to determine whether a performance obligation is satisfied over time) if the entity's performance creates an asset that the customer does not consume immediately as the asset is received. The IFRS IC reiterated this point at its meeting in March 2018, in relation to a contract for the sale of a real estate unit (see Question 7-10 in section 7.1.3 for further discussion).[264] Instead, an entity assesses that performance obligation using the criteria discussed in sections 7.1.2 and 7.1.3.

For some service contracts, the entity's performance will not satisfy its obligation over time because the customer does not consume the benefit of the entity's performance until the entity's performance is complete. The standard provides an example (Example 14, extracted in full in section 7.1.3) of an entity providing consulting services that will take the form of a professional opinion upon the completion of the services. In this situation, an entity cannot conclude that the services are transferred over time based on this criterion. Instead, the entity must consider the remaining two criteria in IFRS 15.35 (see sections 7.1.2 and 7.1.3 and Example 14 below).

Frequently asked questions

Question 7-2: What factors should an entity consider when evaluating whether a customer simultaneously receives and consumes the benefits of a commodity (e.g., electricity, natural gas or heating oil) as the entity performs? [TRG meeting 13 July 2015 – Agenda paper no. 43]

TRG members generally agreed that an entity would consider all known facts and circumstances when evaluating whether a customer simultaneously receives and consumes the benefits of a commodity. These may include the inherent characteristics of the commodity (e.g., whether the commodity can be stored), contract terms (e.g., a continuous supply contract to meet immediate demands) and information about infrastructure or other delivery mechanisms.

As such, revenue related to the sale of a commodity may or may not be recognised over time, depending on whether the facts and circumstances of the contract indicate that the customer simultaneously receives and consumes the benefits. This evaluation may require the use of significant judgement.

Whether a commodity meets this criterion and is transferred over time is important in determining whether the sale of a commodity meets the criteria to apply the series requirement (see section 4.2.2 above). This, in turn, affects how an entity allocates variable consideration and apply the requirements for contract modifications and changes in the transaction price.

7.1.2 Customer controls the asset as it is created or enhanced (updated September 2019)

The second criterion to determine whether control of a good or service is transferred over time requires entities to evaluate whether the customer controls the asset as it is being created or enhanced. For the purpose of this determination, the definition of 'control' is the same as previously discussed (i.e., the ability to direct the use of and obtain substantially all of the remaining benefits from the asset). The IASB explained in the Basis for Conclusions that this criterion addresses situations in which the customer clearly controls any work in progress arising from the entity's performance. The Board provided an

[264] *IFRIC Update*, March 2018, available on the IASB's website.

example in which the entity has entered into a construction contract to build on the customer's land, stating that any work in progress arising from the entity's performance is generally controlled by the customer.[265] IFRS IC also reiterated the overall intent of the criterion and referred to this example from the Basis for Conclusions during its March 2018 meeting (see Question 7-10 in section 7.1.3).[266] In addition, some construction contracts may also contain clauses indicating that the customer owns any work in progress as the contracted item is being built. Furthermore, the asset being created or enhanced can be either tangible or intangible.

How we see it

The Board observed in the Basis for Conclusions that the second over-time criterion (related to the customer's control of the asset as it is being created or enhanced) is consistent with the notion that, in effect, the entity has agreed to sell its rights to the asset (i.e., work in progress) as the entity performs (i.e., a continuous sale).[267]

Frequently asked questions

Question 7-3: How should an entity evaluate a customer's right to sell (or pledge) a right to obtain an asset when determining whether the customer controls the asset as it is created or enhanced under IFRS 15.35(b)?

We believe that an entity needs to assess control of the asset that the entity's performance creates or enhances, rather than any contractual rights to obtain the completed asset in the future. For example, and as discussed by the IFRS IC (see Question 7-10 in section 7.1.3), in a contract for the sale of real estate that the entity constructs, the asset created is the real estate itself and not the customer's right to obtain the completed real estate in the future. That is, an entity would evaluate whether the customer controls the partially constructed real estate as it is being constructed to determine whether the criterion IFRS 15.35(b) is met. The customer's right to sell (or pledge) a right to obtain a completed asset in the future is not evidence that the customer controls the asset itself as it is being created or enhanced.[268]

7.1.3 Asset with no alternative use and right to payment (updated September 2019)

In some cases, it may be unclear whether the asset that an entity creates or enhances is controlled by the customer when considering the first two criteria (discussed in sections 7.1.1 and 7.1.2 above) for evaluating whether control transfers over time. Therefore, the Board added a third criterion, which requires revenue to be recognised over time if both of the following two requirements are met:

- The entity's performance does not create an asset with alternative use to the entity.
- The entity has an enforceable right to payment for performance completed to date.

Each of these concepts is discussed further below.

[265] IFRS 15.BC129.
[266] *IFRIC Update*, March 2018, available on the IASB's website.
[267] IFRS 15.BC130.
[268] *IFRIC Update*, March 2018, available on the IASB's website.

No alternative use

The IASB explained in the Basis for Conclusions that it had developed the notion of 'alternative use' to prevent over time revenue recognition when the entity's performance does not transfer control of the goods or services to the customer over time. When the entity's performance creates an asset with an alternative use to the entity (e.g., standard inventory items), the entity can readily direct the asset to another customer. In those cases, the entity (not the customer) controls the asset as it is created because the customer does not have the ability to direct the use of the asset or restrict the entity from directing that asset to another customer. The standard includes the following requirements for 'alternative use':

Extract from IFRS 15

36. An asset created by an entity's performance does not have an alternative use to an entity if the entity is either restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset or limited practically from readily directing the asset in its completed state for another use. The assessment of whether an asset has an alternative use to the entity is made at contract inception. After contract inception, an entity shall not update the assessment of the alternative use of an asset unless the parties to the contract approve a contract modification that substantively changes the performance obligation. Paragraphs B6–B8 provide guidance for assessing whether an asset has an alternative use to an entity.

...

B6. In assessing whether an asset has an alternative use to an entity in accordance with paragraph 36, an entity shall consider the effects of contractual restrictions and practical limitations on the entity's ability to readily direct that asset for another use, such as selling it to a different customer. The possibility of the contract with the customer being terminated is not a relevant consideration in assessing whether the entity would be able to readily direct the asset for another use.

B7. A contractual restriction on an entity's ability to direct an asset for another use must be substantive for the asset not to have an alternative use to the entity. A contractual restriction is substantive if a customer could enforce its rights to the promised asset if the entity sought to direct the asset for another use. In contrast, a contractual restriction is not substantive if, for example, an asset is largely interchangeable with other assets that the entity could transfer to another customer without breaching the contract and without incurring significant costs that otherwise would not have been incurred in relation to that contract.

B8. A practical limitation on an entity's ability to direct an asset for another use exists if an entity would incur significant economic losses to direct the asset for another use. A significant economic loss could arise because the entity either would incur significant costs to rework the asset or would only be able to sell the asset at a significant loss. For example, an entity may be practically limited from redirecting assets that either have design specifications that are unique to a customer or are located in remote areas.

In making the assessment of whether a good or service has alternative use, an entity must consider any substantive contractual restrictions. A contractual restriction is substantive if a customer could enforce its rights to the promised asset if the entity sought to direct the asset for another use. Contractual restrictions that are not substantive, such as protective rights for the customer, are not considered. The Board explained in the Basis for Conclusions that a protective right typically gives an entity the practical ability to physically substitute or redirect the asset without the customer's knowledge or objection to the change. For example, a contract may specify that an entity cannot transfer a good to another customer because the customer has legal title to the good. Such a contractual term would not be substantive if the entity could physically substitute that good for another and could redirect the original good to another customer for little cost. In that case, the contractual restriction would merely be a protective right and would not indicate that control of the asset has transferred to the customer.[269]

An entity also needs to consider any practical limitations on directing the asset for another use. In making this determination, the Board clarified that an entity considers the characteristics of the asset that ultimately will be transferred to the customer and assesses whether the asset in its completed state could be redirected without a significant cost of rework. The Board provided an example of manufacturing contracts in which the basic design of the asset is the same across all contracts, but substantial customisation is made to the asset. As a result, redirecting the finished asset would require significant rework and the asset would not have an alternative use because the entity would incur significant economic losses to direct the asset for another use.[270]

Considering the level of customisation of an asset may help entities assess whether an asset has an alternative use. The IASB noted in the Basis for Conclusions that, when an entity is creating an asset that is highly customised for a particular customer, it is less likely that the entity could use that asset for any other purpose.[271] That is, it is likely that the entity would need to incur significant rework costs to redirect the asset to another customer or sell the asset at a significantly reduced price. As a result, the asset would not have an alternative use to the entity and the customer could be regarded as receiving the benefit of the entity's performance as the entity performs (i.e., having control of the asset), provided that the entity also has an enforceable right to payment (discussed below). However, the Board clarified that the level of customisation is a factor to consider, but it should not be a determinative factor. For example, in some real estate contracts, the asset may be standardised (i.e., not highly customised), but it still may not have an alternative use to the entity because of substantive contractual restrictions that preclude the entity from readily directing the asset to another customer.[272]

[269] IFRS 15.BC138.
[270] IFRS 15.BC138.
[271] IFRS 15.BC135.
[272] IFRS 15.BC137.

The standard provides the following example to illustrate an evaluation of practical limitations on directing an asset for another use:

Extract from IFRS 15

Example 15 — Asset has no alternative use to the entity (IFRS 15.IE73-IE76)

An entity enters into a contract with a customer, a government agency, to build a specialised satellite. The entity builds satellites for various customers, such as governments and commercial entities. The design and construction of each satellite differ substantially, on the basis of each customer's needs and the type of technology that is incorporated into the satellite.

At contract inception, the entity assesses whether its performance obligation to build the satellite is a performance obligation satisfied over time in accordance with paragraph 35 of IFRS 15.

As part of that assessment, the entity considers whether the satellite in its completed state will have an alternative use to the entity. Although the contract does not preclude the entity from directing the completed satellite to another customer, the entity would incur significant costs to rework the design and function of the satellite to direct that asset to another customer. Consequently, the asset has no alternative use to the entity (see paragraphs 35(c), 36 and B6–B8 of IFRS 15) because the customer-specific design of the satellite limits the entity's practical ability to readily direct the satellite to another customer.

For the entity's performance obligation to be satisfied over time when building the satellite, paragraph 35(c) of IFRS 15 also requires the entity to have an enforceable right to payment for performance completed to date. This condition is not illustrated in this example.

Requiring an entity to assess contractual restrictions when evaluating this criterion may seem to contradict the requirements in IFRS 15.B4 to ignore contractual and practical restrictions when evaluating whether another entity would need to substantially reperform the work the entity has completed to date (see section 7.1.1). The Board explained that this difference is appropriate because each criterion provides a different method for assessing when control transfers and the criteria were designed to apply to different situations.[273]

After contract inception, an entity does not update its assessment of whether an asset has an alternative use for any subsequent changes in facts and circumstances, unless the parties approve a contract modification that substantively changes the performance obligation. The IASB also decided that an entity's lack of an alternative use for an asset does not, by itself, mean that the customer effectively controls the asset. The entity would also need to determine that it has an enforceable right to payment for performance to date, as discussed below.[274]

[273] IFRS 15.BC139.
[274] IFRS 15.BC141.

Enforceable right to payment for performance completed to date

To evaluate whether it has an enforceable right to payment for performance completed to date, the entity is required to consider the terms of the contract and any laws or regulations that relate to it. The standard states that the right to payment for performance completed to date need not be for a fixed amount. However, at any time during the contract term, an entity must be entitled to an amount that at least compensates the entity for performance completed to date (as defined in IFRS 15.B9, see extract below), even if the contract is terminated by the customer (or another party) for reasons other than the entity's failure to perform as promised.[275] The IASB concluded that a customer's obligation to pay for the entity's performance is an indicator that the customer has obtained benefit from the entity's performance.[276]

The standard states the following about an entity's right to payment for performance completed to date:

Extract from IFRS 15

B9. In accordance with paragraph 37, an entity has a right to payment for performance completed to date if the entity would be entitled to an amount that at least compensates the entity for its performance completed to date in the event that the customer or another party terminates the contract for reasons other than the entity's failure to perform as promised. An amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date (for example, recovery of the costs incurred by an entity in satisfying the performance obligation plus a reasonable profit margin) rather than compensation for only the entity's potential loss of profit if the contract were to be terminated. Compensation for a reasonable profit margin need not equal the profit margin expected if the contract was fulfilled as promised, but an entity should be entitled to compensation for either of the following amounts:

(a) a proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity's performance under the contract before termination by the customer (or another party); or

(b) a reasonable return on the entity's cost of capital for similar contracts (or the entity's typical operating margin for similar contracts) if the contract-specific margin is higher than the return the entity usually generates from similar contracts.

B10. An entity's right to payment for performance completed to date need not be a present unconditional right to payment. In many cases, an entity will have an unconditional right to payment only at an agreed-upon milestone or upon complete satisfaction of the performance obligation. In assessing whether it has a right to payment for performance completed to date, an entity shall consider whether it would have an enforceable right to demand or retain payment for performance completed to date if the contract were to be terminated before completion for reasons other than the entity's failure to perform as promised.

[275] IFRS 15.37.
[276] IFRS 15.BC142.

Extract from IFRS 15 (cont'd)

B11. In some contracts, a customer may have a right to terminate the contract only at specified times during the life of the contract or the customer might not have any right to terminate the contract. If a customer acts to terminate a contract without having the right to terminate the contract at that time (including when a customer fails to perform its obligations as promised), the contract (or other laws) might entitle the entity to continue to transfer to the customer the goods or services promised in the contract and require the customer to pay the consideration promised in exchange for those goods or services. In those circumstances, an entity has a right to payment for performance completed to date because the entity has a right to continue to perform its obligations in accordance with the contract and to require the customer to perform its obligations (which include paying the promised consideration).

B12. In assessing the existence and enforceability of a right to payment for performance completed to date, an entity shall consider the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms. This would include an assessment of whether:

(a) legislation, administrative practice or legal precedent confers upon the entity a right to payment for performance to date even though that right is not specified in the contract with the customer;

(b) relevant legal precedent indicates that similar rights to payment for performance completed to date in similar contracts have no binding legal effect; or

(c) an entity's customary business practices of choosing not to enforce a right to payment has resulted in the right being rendered unenforceable in that legal environment. However, notwithstanding that an entity may choose to waive its right to payment in similar contracts, an entity would continue to have a right to payment to date if, in the contract with the customer, its right to payment for performance to date remains enforceable.

The IASB described in the Basis for Conclusions how the factors of 'no alternative use' and the 'right to payment' relate to the assessment of control. Since an entity is constructing an asset with no alternative use to the entity, the entity is effectively creating an asset at the direction of the customer. That asset would have little or no value to the entity if the customer were to terminate the contract. As a result, the entity will seek economic protection from the risk of customer termination by requiring the customer to pay for the entity's performance to date in the event of customer termination. The customer's obligation to pay for the entity's performance to date (or, the inability to avoid paying for that performance) suggests that the customer has obtained the benefits from the entity's performance.[277]

[277] IFRS 15.BC142.

The enforceable right to payment criterion has two components that an entity must assess:

- The amount that the customer would be required to pay

And

- What it means to have the enforceable right to payment

The Board provided additional application guidance on how to evaluate each of these components.

Firstly, the Board explained in the Basis for Conclusions that the focus of the analysis should be on the amount to which the entity would be entitled upon termination.[278] This amount is not the amount the entity would settle for in a negotiation and it does not need to reflect the full contract margin that the entity would earn if the contract were completed. The Board clarified in IFRS 15.B9 that a 'reasonable profit margin' would either be a proportion of the entity's expected profit margin that reasonably reflects the entity's performance to date or a reasonable return on the entity's cost of capital. In addition, the standard clarifies, in IFRS 15.B13, that including a payment schedule in a contract does not, in and of itself, indicate that the entity has the right to payment for performance completed to date. This is because, in some cases, the contract may specify that the consideration received from the customer is refundable for reasons other than the entity failing to perform as promised in the contract. The entity must examine information that may contradict the payment schedule and may represent the entity's actual right to payment for performance completed to date. As highlighted in Example 16 below, payments from a customer must approximate the selling price of the goods or services transferred to date to be considered a right to payment for performance to date. A fixed payment schedule may not meet this requirement.

Secondly, the IASB added application guidance in IFRS 15.B12 to help an entity assess the existence and enforceability of a right to payment. In making this assessment, entities need to consider any laws, legislation or legal precedent that could supplement or override the contractual terms. Furthermore, the standard indicates that an entity may have an enforceable right to payment even when the customer terminates the contract without having the right to terminate. This would be the case if the contract (or other law) entitles the entity to continue to transfer the goods or services promised in the contract and require the customer to pay the consideration promised for those goods or services (often referred to as 'specific performance').[279] The standard also states that even when an entity chooses to waive its right to payment in other similar contracts, an entity would continue to have a right to payment for the contract if, in the contract, its right to payment for performance to date remains enforceable.

[278] IFRS 15.BC144.
[279] IFRS 15.BC145.

The standard provides the following example to illustrate the concepts described in section 7.1.3. Example 14 depicts an entity providing consulting services that will take the form of a professional opinion upon the completion of the services. In this example, the entity's performance obligation meets the no alternative use and right to payment criterion of IFRS 15.35(c), as follows:

Extract from IFRS 15

Example 14 — Assessing alternative use and right to payment (IFRS 15.IE69-IE72)

An entity enters into a contract with a customer to provide a consulting service that results in the entity providing a professional opinion to the customer. The professional opinion relates to facts and circumstances that are specific to the customer. If the customer were to terminate the consulting contract for reasons other than the entity's failure to perform as promised, the contract requires the customer to compensate the entity for its costs incurred plus a 15 per cent margin. The 15 per cent margin approximates the profit margin that the entity earns from similar contracts.

The entity considers the criterion in paragraph 35(a) of IFRS 15 and the requirements in paragraphs B3 and B4 of IFRS 15 to determine whether the customer simultaneously receives and consumes the benefits of the entity's performance. If the entity were to be unable to satisfy its obligation and the customer hired another consulting firm to provide the opinion, the other consulting firm would need to substantially re-perform the work that the entity had completed to date, because the other consulting firm would not have the benefit of any work in progress performed by the entity. The nature of the professional opinion is such that the customer will receive the benefits of the entity's performance only when the customer receives the professional opinion. Consequently, the entity concludes that the criterion in paragraph 35(a) of IFRS 15 is not met.

However, the entity's performance obligation meets the criterion in paragraph 35(c) of IFRS 15 and is a performance obligation satisfied over time because of both of the following factors:

(a) in accordance with paragraphs 36 and B6–B8 of IFRS 15, the development of the professional opinion does not create an asset with alternative use to the entity because the professional opinion relates to facts and circumstances that are specific to the customer. Therefore, there is a practical limitation on the entity's ability to readily direct the asset to another customer.

(b) in accordance with paragraphs 37 and B9–B13 of IFRS 15, the entity has an enforceable right to payment for its performance completed to date for its costs plus a reasonable margin, which approximates the profit margin in other contracts.

Consequently, the entity recognises revenue over time by measuring the progress towards complete satisfaction of the performance obligation in accordance with paragraphs 39–45 and B14–B19 of IFRS 15.

Example 16 illustrates a contract in which the fixed payment schedule is not expected to correspond, at all times throughout the contract, to the amount that would be necessary to compensate the entity for performance completed to date. Accordingly, the entity concludes that it does not have an enforceable right to payment for performance completed to date as follows:

Extract from IFRS 15

Example 16 — Enforceable right to payment for performance completed to date (IFRS 15.IE77-IE80)

An entity enters into a contract with a customer to build an item of equipment. The payment schedule in the contract specifies that the customer must make an advance payment at contract inception of 10 per cent of the contract price, regular payments throughout the construction period (amounting to 50 per cent of the contract price) and a final payment of 40 per cent of the contract price after construction is completed and the equipment has passed the prescribed performance tests. The payments are non-refundable unless the entity fails to perform as promised. If the customer terminates the contract, the entity is entitled only to retain any progress payments received from the customer. The entity has no further rights to compensation from the customer.

At contract inception, the entity assesses whether its performance obligation to build the equipment is a performance obligation satisfied over time in accordance with paragraph 35 of IFRS 15.

As part of that assessment, the entity considers whether it has an enforceable right to payment for performance completed to date in accordance with paragraphs 35(c), 37 and B9–B13 of IFRS 15 if the customer were to terminate the contract for reasons other than the entity's failure to perform as promised. Even though the payments made by the customer are non-refundable, the cumulative amount of those payments is not expected, at all times throughout the contract, to at least correspond to the amount that would be necessary to compensate the entity for performance completed to date. This is because at various times during construction the cumulative amount of consideration paid by the customer might be less than the selling price of the partially completed item of equipment at that time. Consequently, the entity does not have a right to payment for performance completed to date.

Because the entity does not have a right to payment for performance completed to date, the entity's performance obligation is not satisfied over time in accordance with paragraph 35(c) of IFRS 15. Accordingly, the entity does not need to assess whether the equipment would have an alternative use to the entity. The entity also concludes that it does not meet the criteria in paragraph 35(a) or (b) of IFRS 15 and thus, the entity accounts for the construction of the equipment as a performance obligation satisfied at a point in time in accordance with paragraph 38 of IFRS 15.

Example 17 contrasts similar situations and illustrates when revenue would be recognised over time (see section 7.1) versus at a point in time (see section 7.2). Specifically, this example illustrates the evaluation of the 'no alternative use' and 'right to payment for performance to date' concepts, as follows:

Extract from IFRS 15

Example 17 — Assessing whether a performance obligation is satisfied at a point in time or over time (IFRS 15.IE81-IE90)

An entity is developing a multi-unit residential complex. A customer enters into a binding sales contract with the entity for a specified unit that is under construction. Each unit has a similar floor plan and is of a similar size, but other attributes of the units are different (for example, the location of the unit within the complex).

Case A—Entity does not have an enforceable right to payment for performance completed to date

The customer pays a deposit upon entering into the contract and the deposit is refundable only if the entity fails to complete construction of the unit in accordance with the contract. The remainder of the contract price is payable on completion of the contract when the customer obtains physical possession of the unit. If the customer defaults on the contract before completion of the unit, the entity only has the right to retain the deposit.

At contract inception, the entity applies paragraph 35(c) of IFRS 15 to determine whether its promise to construct and transfer the unit to the customer is a performance obligation satisfied over time. The entity determines that it does not have an enforceable right to payment for performance completed to date because, until construction of the unit is complete, the entity only has a right to the deposit paid by the customer.

Because the entity does not have a right to payment for work completed to date, the entity's performance obligation is not a performance obligation satisfied over time in accordance with paragraph 35(c) of IFRS 15. Instead, the entity accounts for the sale of the unit as a performance obligation satisfied at a point in time in accordance with paragraph 38 of IFRS 15.

Case B—Entity has an enforceable right to payment for performance completed to date

The customer pays a non-refundable deposit upon entering into the contract and will make progress payments during construction of the unit. The contract has substantive terms that preclude the entity from being able to direct the unit to another customer. In addition, the customer does not have the right to terminate the contract unless the entity fails to perform as promised. If the customer defaults on its obligations by failing to make the promised progress payments as and when they are due, the entity would have a right to all of the consideration promised in the contract if it completes the construction of the unit. The courts have previously upheld similar rights that entitle developers to require the customer to perform, subject to the entity meeting its obligations under the contract.

Extract from IFRS 15 (cont'd)

At contract inception, the entity applies paragraph 35(c) of IFRS 15 to determine whether its promise to construct and transfer the unit to the customer is a performance obligation satisfied over time. The entity determines that the asset (unit) created by the entity's performance does not have an alternative use to the entity because the contract precludes the entity from transferring the specified unit to another customer. The entity does not consider the possibility of a contract termination in assessing whether the entity is able to direct the asset to another customer.

The entity also has a right to payment for performance completed to date in accordance with paragraphs 37 and B9–B13 of IFRS 15. This is because if the customer were to default on its obligations, the entity would have an enforceable right to all of the consideration promised under the contract if it continues to perform as promised.

Therefore, the terms of the contract and the practices in the legal jurisdiction indicate that there is a right to payment for performance completed to date. Consequently, the criteria in paragraph 35(c) of IFRS 15 are met and the entity has a performance obligation that it satisfies over time. To recognise revenue for that performance obligation satisfied over time, the entity measures its progress towards complete satisfaction of its performance obligation in accordance with paragraphs 39–45 and B14–B19 of IFRS 15.

In the construction of a multi-unit residential complex, the entity may have many contracts with individual customers for the construction of individual units within the complex. The entity would account for each contract separately. However, depending on the nature of the construction, the entity's performance in undertaking the initial construction works (ie the foundation and the basic structure), as well as the construction of common areas, may need to be reflected when measuring its progress towards complete satisfaction of its performance obligations in each contract.

Case C—Entity has an enforceable right to payment for performance completed to date

The same facts as in Case B apply to Case C, except that in the event of a default by the customer, either the entity can require the customer to perform as required under the contract or the entity can cancel the contract in exchange for the asset under construction and an entitlement to a penalty of a proportion of the contract price.

Notwithstanding that the entity could cancel the contract (in which case the customer's obligation to the entity would be limited to transferring control of the partially completed asset to the entity and paying the penalty prescribed), the entity has a right to payment for performance completed to date because the entity could also choose to enforce its rights to full payment under the contract. The fact that the entity may choose to cancel the contract in the event the customer defaults on its obligations would not affect that assessment (see paragraph B11 of IFRS 15), provided that the entity's rights to require the customer to continue to perform as required under the contract (ie pay the promised consideration) are enforceable.

Frequently asked questions

Question 7-4: Should an entity consider the completed asset or the work in progress when assessing whether its performance creates an asset with no alternative use under IFRS 15.35(c)? [FASB TRG meeting 7 November 2016 - Agenda paper no. 56]

FASB TRG members generally agreed that when an entity evaluates whether its performance creates an asset with no alternative use, it should consider whether it could sell the completed asset to another customer without incurring a significant economic loss (i.e., whether it could sell the raw materials or work in progress to another customer is not relevant). This conclusion is supported by the Board's comment in the Basis for Conclusions "that an entity should consider the characteristics of the asset that will ultimately be transferred to the customer".[280]

However, as discussed above in section 7.1.3 and in accordance with IFRS 15.36, if the entity is contractually restricted or has a practical limitation on its ability to direct the asset for another use, the asset would not have an alternative use, regardless of the characteristics of the completed asset. A contractual restriction is substantive if a customer could enforce its rights to the promised asset if the entity sought to direct the asset for another use. A practical limitation exists if an entity would incur a significant economic loss to direct the asset for another use.

The FASB TRG agenda paper included the following example:

Example of no alternative use

An entity enters into a contract with a customer to build customised equipment. The customisation of the equipment occurs when the manufacturing process is approximately 75% complete. That is, for approximately the first 75% of the manufacturing process, the in-process asset could be redirected to fulfil another customer's equipment order (assuming no contractual restrictions). However, the equipment cannot be sold in its completed state to another customer without incurring a significant economic loss. The design specifications of the equipment are unique to the customer and the entity would only be able to sell the completed equipment at a significant economic loss.

The entity would evaluate, at contract inception, whether there is any contractual restriction or practical limitation on its ability to readily direct the asset (in its completed state) for another use. Because the entity cannot sell the completed equipment to another customer without incurring a significant economic loss, the entity has a practical limitation on its ability to direct the equipment in its completed state and, therefore, the asset does not have an alternative use. However, before concluding that revenue should be recognised over time, an entity must evaluate whether it has an enforceable right to payment.

[280] IFRS 15.BC136.

Frequently asked questions (cont'd)

Question 7-5: How should an entity determine whether it has an enforceable right to payment under IFRS 15.35(c)? [FASB TRG meeting 7 November 2016 - Agenda paper no. 56]

FASB TRG members generally agreed that entities need to evaluate the contractual provisions to determine whether the right to payment compensates the entity for performance completed to date. For example, a contract may not explicitly provide an entity with an enforceable right to payment for anything other than finished goods. However, if the termination provisions in the contract allow for a notice period (e.g., 60 days) that would provide sufficient time for an entity to move all work in progress to the finished goods stage, it is likely that an entity would conclude that the contract provides for an enforceable right to payment for performance completed to date. In addition, an entity should consider any legislation or legal precedent that could supplement or override any contractual terms.

The FASB TRG also discussed the linkage amongst right to payment, measure of progress and the timing of the customisation of a good. For example, the FASB TRG noted an entity may not always have an enforceable right to payment at contract inception, such as when an entity is producing standard goods (i.e., inventory) that may be customised for a customer towards the end of the production process. FASB TRG members generally agreed that an entity would need to consider whether it has an enforceable right to payment related to its performance completed to date. If the entity's performance obligation is to customise its standard goods for a customer, FASB TRG members generally agreed that an entity would evaluate whether it has an enforceable right to payment at the point that the entity begins to satisfy the performance obligation to customise the goods for the customer. That is, because the right to payment is for performance completed to date, an entity's performance should coincide with how it defines the nature of its performance obligation and its measure of progress toward satisfaction of that performance obligation.

Question 7-6: In order to have an enforceable right to payment for performance completed to date, does an entity need to have a present unconditional right to payment?

No. In the Basis for Conclusions, the IASB clarified that the contractual payment terms in a contract may not always align with an entity's enforceable rights to payment for performance completed to date. As a result, an entity does not need to have a present unconditional right to payment. Instead, it must have an enforceable right to demand and/or retain payment for performance completed to date upon customer termination without cause. To illustrate this point, the Board included an example of a consulting contract that requires an entity to provide a report at the end of the project. In return, the entity earns a fixed amount, which is due and payable to the entity when it delivers the report. Assume that the entity is performing under the contract and that the contract (or the law) requires the customer to compensate the entity for its performance completed to date. In that situation, the entity would have an enforceable right to payment for performance completed to date, even though an unconditional right to the fixed amount only exists at the time the report is provided to the customer. This is because the entity has a right to demand and retain payment for performance completed to date.[281]

[281] IFRS 15.BC145.

Frequently asked questions (cont'd)

Question 7-7: Does an entity have a right to payment for performance completed to date if the entity receives a non-refundable upfront payment that represents the full transaction price?

Yes. The Board explained in the Basis for Conclusions that such a payment would represent an entity's right to payment for performance completed to date provided that the entity's right to retain and not refund the payment is enforceable upon termination by the customer. This is because a full upfront payment would at least compensate an entity for the work completed to date throughout the contract.[282] If the non-refundable upfront payment does not represent the full transaction price, an entity will have to apply judgement to determine whether the upfront payment provides the entity with a right to payment for performance completed to date in the event of a contract termination.

Question 7-8: Can an entity conclude it has an enforceable right to payment for performance completed to date when a contract is priced at a loss?

Yes, however, the specific facts and circumstances of the contract must be considered. As discussed above, the standard states that, if a contract is terminated for reasons other than the entity's failure to perform as promised, the entity must be entitled to an amount that at least compensates it for its performance to date. Furthermore, IFRS 15.B9 states that "An amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date (for example, recovery of the costs incurred by an entity in satisfying the performance obligation plus a reasonable profit margin)." Accordingly, stakeholders had asked whether an entity could have an enforceable right to payment for performance completed to date if the contract was priced at a loss.

We believe that the example in IFRS 15.B9 of cost recovery plus a reasonable profit margin does not preclude an entity from having an enforceable right to payment even if the contract is priced at a loss. Rather, we believe an entity should evaluate whether it has an enforceable right to receive an amount that approximates the selling price of the goods or services for performance completed to date in the event the customer terminates the contract.

Consider the following example from the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide, *Revenue Recognition*:[283]

Example of determination of enforceable right to payment for a contract priced at a loss

Customer X requests bids for the design of a highly customised system. The customer expects to award subsequent contracts for systems over the next 10 years to the entity that wins the design contract. Contractor A is aware of the competition and knows that in order to win the design contract it must bid the contract at a loss. That is, Contractor A is willing to bid the design contract at a loss due to the significant value in future expected orders.

[282] IFRS 15.BC146.

[283] See AICPA guide, *Revenue Recognition*, Chapter 3, *Aerospace and Defense Entities*, paragraphs 3.5.18 - 3.5.23.

Frequently asked questions (cont'd)

Example of determination of enforceable right to payment for a contract priced at a loss (cont'd)

Contractor A wins the contract with a value of CU100 and estimated costs to complete of CU130. Contractor A has determined that the contract contains a single performance obligation and that its performance does not create an asset with an alternative use. The contract is non-cancellable, however, the contract terms stipulate that if the customer terminates the contract, Contractor A would be entitled to payment for work completed to date. The payment amount would be equal to a proportional amount of the price of the contract based upon the performance of work done to date. For example, if at the termination date Contractor A was 50% complete (i.e., incurred CU65 of costs), it would be entitled to a CU50 payment from Customer X (i.e., 50% of CU100 contract value).

In this example, we believe Contractor A has an enforceable right to payment for performance completed to date. This is in accordance with paragraph IFRS 15.35(c) because Contractor A is entitled to an amount that approximates the selling price of the good or service for performance completed to date in the event the customer terminates the contract.

Refer to section 9.2 regarding accounting for anticipated losses on contracts.

Question 7-9: Can an entity have an enforceable right to payment for performance completed to date if it is not entitled to a reasonable profit margin on standard inventory materials that were purchased but not yet used in completing the performance obligation?

Yes. Consider an example in which an entity agrees to construct a specialised asset for a customer that has no alternative use to the entity. The construction of this asset requires the use of standard inventory materials that could be used interchangeably on other projects of the entity until they are integrated into the production of the customer's asset. The contract with the customer entitles the entity to reimbursement of costs incurred plus a reasonable profit margin if the contract is terminated. However, the contract specifically excludes reimbursement of standard inventory purchases before they are integrated into the customer's asset. As previously discussed, the standard states that, at any time during the contract, an entity must be entitled to an amount that compensates the entity for performance completed to date (as defined in IFRS 15.B9) if the contract is terminated for reasons other than the entity's failure to perform. However, in this example, the standard inventory materials have not yet been used in fulfilling the performance obligation, so the entity does not need to have an enforceable right to payment in relation to these materials. The entity could also repurpose the materials for use in other contracts with customers.

The entity will still need to evaluate whether it has an enforceable right to payment for performance completed to date once the standard inventory materials are used in fulfilling the performance obligation.

Frequently asked questions (cont'd)

Question 7-10: What should an entity consider when assessing the over-time criteria for the sale of a real estate unit?

The IFRS IC received three requests regarding the assessment of the over-time criteria in relation to contracts for the sale of a real estate unit. At its March 2018 meeting, the IFRS IC concluded that the principles and requirements in IFRS 15 provide an adequate basis for an entity to determine whether to recognise revenue over time, or at a point in time, including whether it has an enforceable right to payment for performance completed to date for a contract for the sale of a real estate unit. Consequently, the IFRS IC decided not to add these matters to its agenda.[284]

After considering these requests, the IFRS IC decided that the agenda decisions should discuss the requirements of IFRS 15, as well as how the requirements apply to the fact patterns within the requests. The agenda decisions included the following reminders:

- An entity accounts for contracts within the scope of IFRS 15 only when all the criteria in IFRS 15.9 are met (which includes the collectability criterion).
- Before considering the over-time criteria, an entity is required to apply IFRS 15.22–30 to identify whether each promise to transfer a good or service to the customer is a performance obligation (see section 4.2 for further discussion).
- An entity assesses the over-time criteria in IFRS 15.35 at contract inception. IFRS 15.35 specifies that an entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if any of the three criteria is met. If an entity does not satisfy a performance obligation over time, it satisfies the performance obligation at a point in time.

The agenda decisions also noted the following in relation to the over-time criteria.

Criterion (a)

According to IFRS 15.35(a), an entity recognises revenue over time if the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs. This criterion is not applicable in a contract for the sale of a real estate unit that the entity constructs because the real estate unit created by the entity's performance is not consumed immediately.

Criterion (b)

IFRS 15.35(b) specifies that an entity recognises revenue over time if the customer controls the asset that an entity's performance creates or enhances as the asset is created or enhanced. Control refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. The Board included this criterion to "address situations in which an entity's performance creates or enhances an asset that a customer clearly controls as the asset is created or enhanced".[285] Therefore, all relevant

[284] *IFRIC Update*, March 2018, available on the IASB's website.
[285] IFRS 15.BC129.

Frequently asked questions (cont'd)

facts and circumstances need to be considered by an entity when assessing whether there is evidence that the customer *clearly* controls the asset that is being created or enhanced (e.g., the part-constructed real estate unit) as it is created or enhanced. None of the facts and circumstances is determinative.

The IFRS IC observed that "in a contract for the sale of real estate that the entity constructs, the asset created is the real estate itself. It is not, for example, the right to obtain the real estate in the future. The right to sell or pledge a right to obtain real estate in the future is not evidence of control of the real estate itself".[286] That is, it is important to apply the requirements for control to the asset that the entity's performance creates or enhances (see Question 7-3 in section 7.1.2).

Criterion (c)

The Board developed this third criterion because, in some cases, it may not be clear whether the asset that is created or enhanced is controlled by the customer. IFRS 15.35(c) requires an entity to determine whether: (a) the asset created by an entity's performance does not have an alternative use to the entity; and (b) the entity has an enforceable right to payment for performance completed to date. However, the underlying objective of this criterion is still to determine whether the entity is transferring control of goods or services to the customer as it is creating the asset for that customer. The agenda decisions reiterate that:

- The asset being created does not have an alternative use to the entity if the entity is restricted contractually from readily directing the asset for another use during the asset's creation or if it is limited practically from readily directing the asset in the completed state for another use.[287]
- The entity has an enforceable right to payment if it is entitled to an amount that at least compensates it for performance completed to date were the contract to be terminated by the customer for reasons other than the entity's failure to perform as promised.[288] The entity must be entitled to this amount at all times throughout the duration of the contract and this amount should at least approximate the selling price of the goods or services transferred to date. That is, it is not meant to refer to compensation for only the entity's potential loss of profit were the contract to be terminated. The IFRS IC observed that "it is the payment the entity is entitled to receive under the contract with the customer relating to performance under that contract that is relevant in determining whether the entity has an enforceable right to payment for performance completed to date". As discussed in Question 7-11 below, the IFRS IC also observed that an entity does not consider consideration it might receive upon resale of the asset if the original customer were to terminate the contract.[289]

  In determining whether it has an enforceable right to payment, an entity considers the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms. While an entity does not need to undertake an exhaustive search for evidence, it is not appropriate for an entity to ignore evidence of relevant legal precedent that is available to it or to anticipate evidence that may

[286] *IFRIC Update*, March 2018, available on the IASB's website.
[287] IFRS 15.36; *IFRIC Update*, March 2018, available on the IASB's website.
[288] IFRS 15.37; *IFRIC Update*, March 2018, available on the IASB's website.
[289] *IFRIC Update*, March 2018, available on the IASB's website.

Frequently asked questions (cont'd)

become available in the future. The IFRS IC also observed that "the assessment … is focused on the existence of the right and its enforceability. The likelihood that the entity would exercise the right is not relevant to this assessment. Similarly, if a customer has the right to terminate the contract, the likelihood that the customer would terminate the contract is not relevant to this assessment".[290]

Question 7-11: Does an entity contemplate consideration it might receive from the potential resale of the asset to determine whether an enforceable right to payment for performance completed to date exists? (updated September 2019)

No. We believe that only the payment the entity is entitled to receive relating to performance under the current customer contract is relevant in determining whether the entity has an enforceable right to payment for performance completed to date. For example, and as discussed by the IFRS IC (as discussed in Question 7-10 above), an entity would not look to potential consideration it might receive upon resale of the asset if the original customer were to terminate the contract. This is because the resale of an asset typically represents a separate contract with a different customer and, therefore, is not relevant to determining the existence and enforceability of a right to payment with the existing customer.

Consider the following example discussed by the IFRS IC:[291]

Example of determining whether an enforceable right to payment exists when cancellation by a customer obliges an entity to resell the asset

Entity X, a construction company, enters into a contract with a customer to sell a real estate unit in a residential multi-unit complex before the entity constructs the unit. The entity determines that it has a single performance obligation to construct and deliver the real estate unit. The customer pays 10% of the purchase price at contract inception and the remainder after construction is complete. The entity retains legal title to the real estate unit (and any land attributed to it) until the customer has paid the purchase price after construction is complete.

Under the contract, the customer has the right to cancel the contract at any time before construction is complete. However, if it does, the entity is legally required to make reasonable efforts to resell the real estate unit to a third party. If the entity finds a new buyer, a new contract is executed and the original contract is not novated to the third party. If the resale price in the contract with the third party is less than the original purchase price (plus selling costs), the customer is legally obliged to pay the difference to the entity.

The entity concludes that the over-time criteria in IFRS 15.35(a) and (b) are not met. In considering the over-time criterion in IFRS 15.35(c), the entity determines that its performance does not create an asset with an alternative use to the entity. It, therefore, considers whether it has an enforceable right to payment.

[290] *IFRIC Update*, March 2018, available on the IASB's website.
[291] *IFRIC Update*, March 2018, available on the IASB's website.

Frequently asked questions (cont'd)

Example of determining whether an enforceable right to payment exists when cancellation by a customer obliges an entity to resell the asset (cont'd)

The Committee observed that, when determining whether an entity has an enforceable right to payment, an entity considers the payment to which it is entitled under the existing contract with the customer, which relates to its performance under that contract. It does not consider the consideration it would receive from a third party in a potential resale contract. Such consideration relates to that resale contract and is not payment for performance under the existing contract with the customer.

Since Entity X cannot consider the resale contract, the only future payment to which it has rights under the existing contract with the customer is for the difference between the resale price of the unit, if any, and its original purchase price (plus selling costs). That payment, together with the deposit received, does not (at all times throughout the duration of the contract) entitle the entity to an amount that at least approximates the selling price of the part-constructed real estate unit (i.e., it does not compensate for performance completed to date). Therefore, Entity X does not have an enforceable right to payment for performance completed to date. The Committee concluded that none of the over-time criteria are met and the entity would recognise revenue at a point in time in accordance with IFRS 15.38.

7.1.4 Measuring progress (updated October 2020)

When an entity has determined that a performance obligation is satisfied over time, the standard requires the entity to select a single revenue recognition method for the relevant performance obligation that faithfully depicts the entity's performance in transferring control of the goods or services. An entity should apply the method selected consistently to similar performance obligations. In addition, at the end of each reporting period, an entity is required to remeasure its progress toward completion of the performance obligation. The standard provides the following requirements to meet this objective:

Extract from IFRS 15

Methods for measuring progress

41. Appropriate methods of measuring progress include output methods and input methods. Paragraphs B14–B19 provide guidance for using output methods and input methods to measure an entity's progress towards complete satisfaction of a performance obligation. In determining the appropriate method for measuring progress, an entity shall consider the nature of the good or service that the entity promised to transfer to the customer.

Extract from IFRS 15 (cont'd)

42. When applying a method for measuring progress, an entity shall exclude from the measure of progress any goods or services for which the entity does not transfer control to a customer. Conversely, an entity shall include in the measure of progress any goods or services for which the entity does transfer control to a customer when satisfying that performance obligation.

43. As circumstances change over time, an entity shall update its measure of progress to reflect any changes in the outcome of the performance obligation. Such changes to an entity's measure of progress shall be accounted for as a change in accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

While the standard (i.e., IFRS 15.40) requires an entity to remeasure its progress towards satisfaction of an over-time performance obligation at the end of each reporting period related to the measure of progress selected, it does not permit a change in method. A performance obligation is accounted for using the method the entity selects (i.e., either the specific input or output method it has chosen) from inception until the performance obligation has been fully satisfied. It would not be appropriate for an entity to start recognising revenue based on an input measure and later switch to an output measure (or to switch from one input method to a different input method). Furthermore, the standard requires that the selected method be applied to similar contracts in similar circumstances. It also requires that a single method of measuring progress be used for each performance obligation. The Board noted that applying more than one method to measure performance would effectively override the guidance on identifying performance obligations.[292]

When measuring progress of an over-time performance obligation, IFRS 15.42 requires an entity to exclude any goods or services for which it does not transfer control to a customer. Conversely, an entity must include in the measure of progress any goods or services for which the entity does transfer control to a customer when satisfying that performance obligation.

IFRS 15.43 notes that changes in circumstances over time may require an entity to update its measure of progress to reflect any changes in the outcome of the performance obligation. For example, an entity may determine that total expected costs are greater than its original expectation. If the entity was using an input method based on costs incurred, it would need to update its measure-of-progress calculation with this new information.

Changes to an entity's measure of progress are accounted for in accordance with the requirements in IAS 8 for changes in accounting estimates. IAS 8 requires a change in accounting estimate to be accounted for prospectively, i.e., by adjusting the carrying amount of an asset, liability or item of equity in the statement of financial position; and recognising the change by including it "in profit or loss in: (1) the period of the change, if the change affects that period only; or (2) the period of the change and future periods, if the change affects both".[293] IAS 8 is clear that a change in accounting estimate, by its nature, does not relate to prior periods and is not the correction of an error.[294] The disclosure requirements in IAS 8 related to changes in accounting estimates are also applicable.

[292] IFRS 15.BC161.
[293] IAS 8.5, 36-37.
[294] IAS 8.34.

If an entity does not have a reasonable basis to measure its progress, revenue cannot be recognised until progress can be reasonably measured in accordance with IFRS 15.44. However, if an entity can determine that a loss will not be incurred, the standard (i.e., IFRS 15.45) requires the entity to recognise revenue up to the amount of the costs incurred. The IASB explained that an entity would need to stop using this method once it is able to reasonably measure its progress towards satisfaction of the performance obligation.[295] A cumulative catch-up adjustment would be recognised in the period in which the entity is able to reasonably measure its progress.

Finally, stakeholders had asked whether an entity's inability to measure progress would mean that costs incurred would also be deferred. The Board clarified that costs cannot be deferred in these situations, unless they meet the criteria for capitalisation under IFRS 15.95 (see section 9.3.2).[296]

The standard provides two methods for recognising revenue on contracts involving the transfer of goods or services over time: input methods and output methods. The standard contains the following application guidance on these methods:

Extract from IFRS 15

Output methods

B15. Output methods recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed and units produced or units delivered. When an entity evaluates whether to apply an output method to measure its progress, the entity shall consider whether the output selected would faithfully depict the entity's performance towards complete satisfaction of the performance obligation. An output method would not provide a faithful depiction of the entity's performance if the output selected would fail to measure some of the goods or services for which control has transferred to the customer. For example, output methods based on units produced or units delivered would not faithfully depict an entity's performance in satisfying a performance obligation if, at the end of the reporting period, the entity's performance has produced work in progress or finished goods controlled by the customer that are not included in the measurement of the output.

B16. As a practical expedient, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognise revenue in the amount to which the entity has a right to invoice.

B17. The disadvantages of output methods are that the outputs used to measure progress may not be directly observable and the information required to apply them may not be available to an entity without undue cost. Therefore, an input method may be necessary.

[295] IFRS 15.BC180.
[296] IFRS 15.BC179.

Extract from IFRS 15 (cont'd)

Input methods

B18. Input methods recognise revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation. If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognise revenue on a straight-line basis.

In determining the best method for measuring progress that faithfully depicts an entity's performance, an entity needs to consider both the nature of the promised goods or services and the nature of the entity's performance. In other words, an entity's selection of a method to measure its performance needs to be consistent with the nature of its promise to the customer and what the entity has agreed to transfer to the customer. To illustrate this concept, the Basis for Conclusions cites, as an example, a contract for health club services.[297] Regardless of when, or how frequently, the customer uses the health club, the entity's obligation to stand ready for the contractual period does not change. Furthermore, the customer is required to pay the fee regardless of whether the customer uses the health club. As a result, the entity would need to select a measure of progress based on its service of standing ready to make the health club available. Example 18 in the standard (see section 7.1.4.C) illustrates how a health club might select this measure of progress.

7.1.4.A Output methods

While there is no preferable measure of progress, the IASB stated in the Basis for Conclusions that, conceptually, an output measure is the most faithful depiction of an entity's performance. This is because it directly measures the value of the goods or services transferred to the customer.[298] However, the Board discussed two output methods that may not be appropriate in many instances if the entity's performance obligation is satisfied over time: units of delivery and units of production.[299]

Units-of-delivery or units-of-production methods may not result in the best depiction of an entity's performance over time if there is material work in progress at the end of the reporting period. In these cases, the IASB observed that using a units-of-delivery or units-of-production method would distort the entity's performance because it would not recognise revenue for the customer-controlled assets that are created before delivery or before construction is complete. This is because, when an entity determines control transfers to the customer over time, it has concluded that the customer controls any resulting asset as it is created. Therefore, the entity must recognise revenue related to those goods or services for which control has transferred. The IASB also stated, in the Basis for Conclusions, that a units-of-delivery or units-of-production method may not be appropriate if the contract provides both design and production services because each item produced "may not transfer an equal amount of value to the customer".[300] That is, it is likely that the items produced earlier have a higher value than those that are produced later.

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[297] IFRS 15.BC164.
[298] IFRS 15.BC160.
[299] IFRS 15.BC165.
[300] IFRS 15.BC166.

It is important to note that 'value to the customer' in IFRS 15.B15 refers to an objective method of measuring the entity's performance in the contract. This is not intended to be assessed by reference to the market prices, stand-alone selling prices or the value a customer perceives to be embodied in the goods or services.[301] The TRG agenda paper noted that this concept of value is different from the concept of value an entity uses to determine whether it can use the 'right to invoice' practical expedient, as discussed below. When an entity determines whether items individually transfer an equal amount of value to the customer (i.e., when applying IFRS 15.B15), the evaluation related to how much, or what proportion, of the goods or services (i.e., quantities) have been delivered (but not the price). For example, for the purpose of applying IFRS 15.B15, an entity might consider the amount of goods or services transferred to date in proportion to the total expected goods or services to be transferred when measuring progress. However, if this measure of progress results in material work in progress at the end of the reporting period, it would not be appropriate, as discussed above.[302] See the discussion below regarding the evaluation of 'value to the customer' in the context of evaluating the 'right to invoice' practical expedient in IFRS 15.B16.

Practical expedient for measuring progress towards satisfaction of a performance obligation

The IASB provided a practical expedient in IFRS 15.B16 for an entity that is using an output method to measure progress towards completion of a performance obligation that is satisfied over time. The practical expedient only applies if an entity can demonstrate that the invoiced amount corresponds directly with the value to the customer of the entity's performance completed to date. In that situation, the practical expedient allows an entity to recognise revenue in the amount for which it has the right to invoice (i.e., the 'right to invoice' practical expedient). An entity may be able to use this practical expedient for a service contract in which an entity bills a fixed amount for each hour of service provided.

A TRG agenda paper noted that IFRS 15.B16 is intended as an expedient to some aspects of Step 3, Step 4 and Step 5 in the standard. Because this practical expedient allows an entity to recognise revenue on the basis of invoicing, revenue is recognised by multiplying the price (assigned to the goods or services delivered) by the measure of progress (i.e., the quantities or units transferred). Therefore, an entity effectively bypasses the steps in the model for determining the transaction price, allocating that transaction price to the performance obligations and determining when to recognise revenue. However, it does not permit an entity to bypass the requirements for identifying the performance obligations in the contract and evaluating whether the performance obligation is satisfied over time, which is a requirement to use this expedient.[303]

To apply the practical expedient, an entity must also be able to assert that the right to consideration from a customer corresponds directly with the value to the customer of the entity's performance to date. When determining whether the amount that has been invoiced to the customer corresponds directly with the value to the customer of an entity's performance completed to date, the entity could evaluate the amount that has been invoiced in comparison to market prices, stand-alone selling prices or another reasonable measure of value to the customer. See Question 7-16 in section 7.1.4.C for the TRG discussion on evaluating value to the customer in contracts with changing rates.

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[301] IFRS 15.BC163.

[302] TRG Agenda paper no. 40, *Practical Expedient for Measuring Progress toward Complete Satisfaction of a Performance Obligation*, dated 13 July 2015.

[303] TRG Agenda paper no. 40, *Practical Expedient for Measuring Progress toward Complete Satisfaction of a Performance Obligation*, dated 13 July 2015.

Furthermore, TRG members also noted in their discussion of the TRG agenda paper that an entity would have to evaluate all significant upfront payments or retrospective adjustments (e.g., accumulating rebates) in order to determine whether the amount the entity has a right to invoice for each good or service corresponds directly to the value to the customer of the entity's performance completed to date. That is, if an upfront payment or retrospective adjustment significantly shifts payment for value to the customer to the front or back-end of a contract, it may be difficult for an entity to conclude that the amount invoiced corresponds directly with the value provided to the customer for goods or services.[304]

The TRG agenda paper also stated that the presence of an agreed-upon customer payment schedule does not mean that the amount an entity has the right to invoice corresponds directly with the value to the customer of the entity's performance completed to date. In addition, the TRG agenda paper stated that the existence of specified contract minimums (or volume discounts) would not always preclude the application of the practical expedient, provided that these clauses are deemed non-substantive (e.g., the entity expects to receive amounts in excess of the specified minimums).[305]

7.1.4.B Input methods (updated October 2020)

Input methods recognise revenue based on an entity's efforts or inputs towards satisfying a performance obligation relative to the total expected efforts or inputs to satisfy the performance obligation. Examples of input methods mentioned in the standard include costs incurred, time elapsed, resources consumed or labour hours expended. An entity is required to select a single measure of progress for each performance obligation that depicts the entity's performance in transferring control of the goods or services promised to a customer. If an entity's efforts or inputs are used evenly throughout the entity's performance period, a time-based measure that results in a straight-line recognition of revenue may be appropriate. However, there may be a disconnect between an entity's inputs (e.g., cost of non-distinct goods included in a single performance obligation satisfied over time) and the depiction of an entity's performance to date. The standard includes specific application guidance on adjustments to the measure of progress that may be necessary in those situations. See below for additional discussion.

Regardless of which method an entity selects, it excludes from its measure of progress any goods or services for which control has not transferred to the customer. Likewise, if an entity uses an input method based on costs incurred, it excludes from its measure of progress those costs that do not reflect its performance in transferring a good or service to the customer (e.g., borrowing costs incurred, which it incurs to fund its activities, rather than to fulfil a performance obligation).

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[304] TRG Agenda paper no. 40, *Practical Expedient for Measuring Progress toward Complete Satisfaction of a Performance Obligation*, dated 13 July 2015.

[305] TRG Agenda paper no. 44, *July 2015 Meeting – Summary of Issues Discussed and Next Steps,* dated 9 November 2015.

Adjustments to the measure of progress based on an input method

If an entity applies an input method that uses costs incurred to measure its progress towards completion (e.g., cost to cost), the cost incurred may not always be proportionate to the entity's progress in satisfying the performance obligation. To address this shortcoming of input methods, the standard provides the following guidance:

Extract from IFRS 15

B19. A shortcoming of input methods is that there may not be a direct relationship between an entity's inputs and the transfer of control of goods or services to a customer. Therefore, an entity shall exclude from an input method the effects of any inputs that, in accordance with the objective of measuring progress in paragraph 39, do not depict the entity's performance in transferring control of goods or services to the customer. For instance, when using a cost-based input method, an adjustment to the measure of progress may be required in the following circumstances:

(a) When a cost incurred does not contribute to an entity's progress in satisfying the performance obligation. For example, an entity would not recognise revenue on the basis of costs incurred that are attributable to significant inefficiencies in the entity's performance that were not reflected in the price of the contract (for example, the costs of unexpected amounts of wasted materials, labour or other resources that were incurred to satisfy the performance obligation).

(b) When a cost incurred is not proportionate to the entity's progress in satisfying the performance obligation. In those circumstances, the best depiction of the entity's performance may be to adjust the input method to recognise revenue only to the extent of that cost incurred. For example, a faithful depiction of an entity's performance might be to recognise revenue at an amount equal to the cost of a good used to satisfy a performance obligation if the entity expects at contract inception that all of the following conditions would be met:

    (i) the good is not distinct;

    (ii) the customer is expected to obtain control of the good significantly before receiving services related to the good;

    (iii) the cost of the transferred good is significant relative to the total expected costs to completely satisfy the performance obligation; and

    (iv) the entity procures the good from a third party and is not significantly involved in designing and manufacturing the good (but the entity is acting as a principal in accordance with paragraphs B34–B38).

In a combined performance obligation comprised of non-distinct goods or services, the customer may obtain control of some of the goods before the entity provides the services related to those goods. This could be the case when goods are delivered to a customer site, but the entity has not yet integrated the goods into the overall project (e.g., the materials are 'uninstalled'). The Board concluded that, if an entity were using a percentage-of-completion method based on costs incurred to measure its progress (i.e., cost-to-cost), the measure of progress may be inappropriately affected by the delivery of these goods and that a pure application of such a measure of progress would result in overstated revenue.[306]

IFRS 15.B19 indicates that, in such circumstances (e.g., when control of the individual goods has transferred to the customer, but the integration service has not yet occurred), the best depiction of the entity's performance may be to recognise revenue at an amount equal to the cost of the goods used to satisfy the performance obligation (i.e., a zero margin). This is because the costs incurred are not proportionate to an entity's progress in satisfying the performance obligation. It is also important to note that determining when control of the individual goods (that are part of a performance obligation) have transferred to the customer requires judgement.

The Board noted that the adjustment to the cost-to-cost measure of progress for uninstalled materials is generally intended to apply to a subset of construction-type goods that have a significant cost relative to the contract and for which the entity is effectively providing a simple procurement service to the customer.[307] By applying the adjustment to recognise revenue at an amount equal to the cost of uninstalled materials, an entity is recognising a margin similar to the one the entity would have recognised if the customer had supplied the materials. The IASB clarified that the outcome of recognising no margin for uninstalled materials is necessary to adjust the cost-to-cost calculation to faithfully depict an entity's performance.[308]

In addition, situations may arise in which not all of the costs incurred contribute to the entity's progress in completing the performance obligation. IFRS 15.B19(a) requires that, under an input method, an entity exclude these types of costs (e.g., costs related to significant inefficiencies, wasted materials, required rework) from the measure of progress, unless such costs were reflected in the price of the contract.

The standard includes the following example, illustrating how uninstalled materials are considered in measuring progress towards complete satisfaction of a performance obligation:

Extract from IFRS 15

Example 19 — Uninstalled materials (IFRS 15.IE95-IE100)

In November 20X2, an entity contracts with a customer to refurbish a 3-storey building and install new elevators for total consideration of CU5 million. The promised refurbishment service, including the installation of elevators, is a single performance obligation satisfied over time. Total expected costs are CU4 million, including CU1.5 million for the elevators. The entity determines that it acts as a principal in accordance with paragraphs B34–B38 of IFRS 15, because it obtains control of the elevators before they are transferred to the customer.

[306] IFRS 15.BC171.
[307] IFRS 15.BC172.
[308] IFRS 15.BC174.

Extract from IFRS 15 (cont'd)

A summary of the transaction price and expected costs is as follows:

	CU
Transaction price	5,000,000
Expected costs	
Elevators	1,500,000
Other costs	2,500,000
Total expected costs	4,000,000

The entity uses an input method based on costs incurred to measure its progress towards complete satisfaction of the performance obligation. The entity assesses whether the costs incurred to procure the elevators are proportionate to the entity's progress in satisfying the performance obligation, in accordance with paragraph B19 of IFRS 15. The customer obtains control of the elevators when they are delivered to the site in December 20X2, although the elevators will not be installed until June 20X3. The costs to procure the elevators (CU1.5 million) are significant relative to the total expected costs to completely satisfy the performance obligation (CU4 million). The entity is not involved in designing or manufacturing the elevators.

The entity concludes that including the costs to procure the elevators in the measure of progress would overstate the extent of the entity's performance. Consequently, in accordance with paragraph B19 of IFRS 15, the entity adjusts its measure of progress to exclude the costs to procure the elevators from the measure of costs incurred and from the transaction price. The entity recognises revenue for the transfer of the elevators in an amount equal to the costs to procure the elevators (ie at a zero margin). As of 31 December 20X2 the entity observes that:

(a) other costs incurred (excluding elevators) are CU500,000; and

(b) performance is 20 per cent complete (ie CU500,000 ÷ CU2,500,000).

Consequently, at 31 December 20X2, the entity recognises the following:

	CU	
Revenue	2,200,000	(a)
Cost of goods sold	2,000,000	(b)
Profit	200,000	

(a) Revenue recognised is calculated as (20 per cent × CU3,500,000) + CU1,500,000. (CU3,500,000 is CU5,000,000 transaction price – CU1,500,000 costs of elevators.)

(b) Cost of goods sold is CU500,000 of costs incurred + CU1,500,000 costs of elevators.

When costs for uninstalled materials are excluded from the measure of progress and those materials are subsequently installed, an entity will need to apply significant judgement, based on its assessment of which treatment best depicts its performance in the contract, to determine whether the costs should be: (a) included in the measure of progress upon installation; or (b) excluded from the measure of progress for the duration of the contract.

Approach (a): once the materials have been installed, the costs for those materials are included in the measure of progress

IFRS 15.B19(b) can be read to apply only while materials are uninstalled. Once installed, it no longer applies to the materials and the entity reverts to the general requirements for measuring progress over time. The Basis for Conclusions indicates that recognising the profit margin for the performance obligation as a whole *before* the goods are installed could result in overstated

revenue, and that IFRS 15.B19(b) applies to uninstalled materials and that it is only those materials that are *not yet installed* that attract a zero margin.[309] Furthermore, Example 19 of IFRS 15 illustrates the accounting for materials before they are installed (at the point in time that control of those materials has passed to the customer) and not after being installed.

When the profit margin applicable to the procured item(s) differs significantly from the profit margin attributable to other goods and services to be provided in accordance with the contract, the application of the profit margin for the performance obligation as a whole may overstate the amount of revenue and profit that is attributed to the procured item(s). Entities will need to consider whether the outcome of applying this approach is consistent with the underlying principle in IFRS 15.39, that the amount of revenue recognised depict its performance, as it satisfies its performance obligation.

If this approach is used, an entity needs to ensure it does not use a profit margin that differs from the profit margin for the performance obligation as a whole. That is, it should not attribute different profit margins to each component within a single performance obligation. This would effectively treat each component as a separate performance obligation when they are not distinct (and, therefore, inappropriately bypass the requirements for identifying performance obligations).[310]

Approach (b): the costs for uninstalled materials are excluded from the measure of progress for the duration of the contract

IFRS 15.B19(b) does not distinguish goods that have been installed from those that have not yet been installed and the adjustments to the measure of progress in Example 19 of IFRS 15 can be read to apply for the duration of the contract.[311] As discussed above, IFRS 15.B19(b) is generally intended to apply to a subset of construction-type goods that have a significant cost relative to the contract and for which the entity is effectively providing a simple procurement service to the customer or if the customer had supplied the materials themselves.[312]

Approach (b) shifts the margin from uninstalled materials to the other components within the single performance obligation, which is recognised as the related costs are incurred (and included in the measure of progress). Entities may need to consider whether this reflects their performance if they typically charge a margin for procurement of similar materials.

How we see it

As discussed above and in the Basis for Conclusions on IFRS 15, the IASB generally intended the application guidance to apply to a subset of construction-type goods that have a significant cost relative to the contract and for which the entity is effectively providing a simple procurement service to the customer.[313] This was confirmed in a speech by a member of the SEC staff who noted that the staff would be sceptical of broad application of the uninstalled materials application guidance.[314]

[309] IFRS 15.BC171-BC172, BC174.
[310] IFRS 15.BC171.
[311] IFRS 15.IE98.
[312] IFRS 15.BC172.
[313] IFRS 15.BC172.
[314] Speech by Sylvia Alicea, Professional Accounting Fellow, SEC Office of the Chief Accountant, 8 May 2017, SEC.gov.

7.1.4.C Examples (updated October 2020)

The following example illustrates some possible considerations when determining an appropriate measure of progress:

Illustration 7-1 — Choosing the measure of progress

A ship-building entity enters into a contract to build 15 vessels for a customer over a three-year period. The contract includes both design and production services. The entity has not built a vessel of this type in the past. In addition, the entity expects that the first vessels may take longer to produce than the last vessels because, as the entity gains experience building the vessels, it expects to be able to construct the vessels more efficiently.

Assume that the entity has determined that the design and production services represent a single performance obligation. In this situation, it is likely that the entity would not choose a 'units-of-delivery' method as a measure of progress because that method would not accurately capture the level of performance. That is, such a method would not reflect the entity's efforts during the design phase of the contract because no revenue would be recognised until a vessel was shipped. In such situations, an entity would likely determine that an input method is more appropriate, such as a percentage of completion method based on costs incurred.

The standard also includes the following example on selecting an appropriate measure of progress towards satisfaction of a performance obligation:

Extract from IFRS 15

Example 18 — Measuring progress when making goods or services available (IFRS 15.IE92-IE94)

An entity, an owner and manager of health clubs, enters into a contract with a customer for one year of access to any of its health clubs. The customer has unlimited use of the health clubs and promises to pay CU100 per month.

The entity determines that its promise to the customer is to provide a service of making the health clubs available for the customer to use as and when the customer wishes. This is because the extent to which the customer uses the health clubs does not affect the amount of the remaining goods and services to which the customer is entitled. The entity concludes that the customer simultaneously receives and consumes the benefits of the entity's performance as it performs by making the health clubs available. Consequently, the entity's performance obligation is satisfied over time in accordance with paragraph 35(a) of IFRS 15.

The entity also determines that the customer benefits from the entity's service of making the health clubs available evenly throughout the year. (That is, the customer benefits from having the health clubs available, regardless of whether the customer uses it or not.) Consequently, the entity concludes that the best measure of progress towards complete satisfaction of the performance obligation over time is a time-based measure and it recognises revenue on a straight-line basis throughout the year at CU100 per month.

Frequently asked questions

Question 7-12: How would an entity measure progress towards satisfaction of a stand-ready obligation that is satisfied over time? [TRG meeting 26 January 2015 – Agenda paper no. 16]

TRG members generally agreed that an entity should not default to a straight-line revenue attribution model. However, they also generally agreed that if an entity expects the customer to receive and consume the benefits of its promise throughout the contract period, a time-based measure of progress (e.g., straight-line) would be appropriate. The TRG agenda paper noted that this is generally the case for unspecified upgrade rights, help-desk support contracts and cable or satellite television contracts. In contrast, TRG members generally agreed that rateable recognition may not be appropriate if the benefits are not spread evenly over the contract period (e.g., an annual snow removal contract that provides most benefits in winter).

As discussed in Question 4-11 in section 4.2.2, we generally believe that a stand-ready obligation that is satisfied over time will meet the criteria to be accounted for as a series of distinct goods and services. Similar to the discussion above, while it is not appropriate to default to a straight-line revenue attribution model for a series, straight-line revenue recognition may be reasonable in many cases. Management should select the measure of progress that faithfully depicts the entity's performance in transferring the goods or services promised in a series.

Question 7-13: Can multiple measures of progress be used to depict an entity's performance in transferring a performance obligation comprised of two or more goods and/or services that is satisfied over time (i.e., a combined performance obligation)?[315] ***[TRG meeting 13 July 2015 – Agenda paper no. 41]***

TRG members agreed that when an entity has determined that a combined performance obligation is satisfied over time, the entity has to select a single measure of progress that faithfully depicts the entity's performance in transferring the goods or services. For example, using different measures of progress for different non-distinct goods or services in the combined performance obligation would be inappropriate because doing so ignores the unit of account that has been identified under the standard (i.e., the single combined performance obligation). Furthermore, it would also be inappropriate because the entity would recognise revenue in a way that overrides the separation and allocation requirements in the standard.[316]

The TRG agenda paper noted that a single method of measuring progress should not be broadly interpreted to mean an entity may apply multiple measures of progress as long as all measures used are either output or input measures.

[315] Under Step 2 of the model (see section 4), a single performance obligation may contain multiple non-distinct goods or services and/or distinct goods or services that were required to be combined with non-distinct goods or services in order to identify a distinct bundle. This bundled performance obligation is referred to as a 'combined performance obligation' for the purpose of this discussion.

[316] IFRS 15.BC161.

Frequently asked questions (cont'd)

Question 7-14: How would an entity determine the appropriate single measure of progress for a combined performance obligation that is satisfied over time? [TRG meeting 13 July 2015 – Agenda paper no. 41]

TRG members acknowledged that it may be difficult to appropriately determine a single measure of progress when the entity transfers goods or services that make up the combined performance obligation over different points of time and/or the entity would otherwise use a different measure of progress (e.g., a time-based method versus a labour-based input method) if each promise was a separate performance obligation.

Such a determination requires significant judgement, but TRG members generally agreed that the measure of progress selected is not meant to be a 'free choice'. Entities need to consider the nature of the overall promise for the combined performance obligation in determining the measure of progress to use. For example, entities should not default to a 'final deliverable' methodology, such that all revenue would be recognised over the performance period of the last promised good or service. Rather, an entity is required to select the single measure of progress that most faithfully depicts the entity's performance in satisfying its combined performance obligation.

Some TRG members observed that an entity would need to consider the reasons why goods or services were bundled into a combined performance obligation in order to determine the appropriate pattern of revenue recognition. For example, if a good or service was combined with other goods or services because it was not capable of being distinct, that may indicate that it does not provide value or use to the customer on its own. As such, the entity would not contemplate the transfer of that good or service when determining the pattern of revenue recognition for the combined performance obligation.

TRG members also generally agreed that, if an appropriately selected single measure of progress does not faithfully depict the economics of the arrangement, the entity should challenge whether the performance obligation was correctly combined (i.e., there may be more than one performance obligation).

Consider the following example included in the TRG paper:

Example of combined licence and installation service performance obligation

An entity promises to provide a software licence and installation services that will substantially customise the software to add significant new functionality that enables the software to interface with other customised applications used by the customer.

The entity concludes that the software and services are not separately identifiable from the customised installation service, and the criterion in IFRS 15.27(b) is not met (see section 4.2.1). Therefore, the software licence and installation service are combined into a single performance obligation and the entity concludes that the combined performance obligation is satisfied over time. If the licence was distinct, it would be considered a right-to-use licence and revenue would be recognised at a point in time.

Frequently asked questions (cont'd)

Example of combined licence and installation service performance obligation (cont'd)

The entity further determines that the nature of its overall promise is to develop the customised software over time. Accordingly, the entity determines that it should use a measure of progress that depicts the performance of completing the customised software solution. Therefore, all of the revenue for this contract would be recognised over the period that the customisation services are performed.

Question 7-15: Can control of a good or service underlying a performance obligation satisfied over time be transferred at discrete points in time? [FASB TRG meeting 18 April 2016 – Agenda paper no. 53]

FASB TRG members generally agreed that, if a performance obligation meets the criteria for revenue to be recognised over time (rather than at a point in time), control of the underlying good or service is not transferred at discrete points in time. Because control transfers as an entity performs, an entity's performance (as reflected using an appropriate measure of progress) should not result in the creation of a material asset in the entity's accounts (e.g., work in progress).

Stakeholders had queried whether control of a good or service underlying a performance obligation that is satisfied over time can be transferred at discrete points in time because the standard highlights several output methods, including 'milestones reached', as potentially acceptable methods for measuring progress towards satisfaction of an over-time performance obligation. FASB TRG members generally agreed that an entity could use an output method only if that measure of progress correlates to the entity's performance to date.

At the May 2016 IASB meeting, IASB staff indicated support for the conclusions reached in the TRG agenda paper on this issue, noting that it provides some clarity about when to use milestones reached as a measure of progress. Furthermore, the members of the IASB who observed the FASB TRG meeting indicated that the FASB TRG discussion on the topic was helpful.

Question 7-16: Can an entity use the 'right to invoice' practical expedient for a contract that includes rates that change over the contractual term? [TRG meeting 13 July 2015 – Agenda paper no. 40]

TRG members generally agreed that determining whether an entity can apply the 'right to invoice' practical expedient requires judgement. They also generally agreed that it is possible for entities to meet the requirements for the practical expedient in contracts with changing rates, provided that the changes in rates correspond directly to changes in value to the customer. That is, a contract does not need to have a fixed price per unit for the duration of a contract in order to qualify for the practical expedient. Examples of contracts that might qualify include an IT outsourcing arrangement with rates that decrease over the contract term as the level of effort to the customer decreases or a multi-year electricity contract that contemplates the forward market price of electricity. However, the SEC staff observer also noted that entities need to have strong evidence that variable prices reflect the value to the customer in order to recognise variable amounts of revenue for similar goods or services.

Frequently asked questions (cont'd)

Question 7-17: If an entity does not met the criteria to use the 'right to invoice' practical expedient, can it still use the disclosure practical expedient regarding the amount of transaction price allocated to remaining performance obligations? [TRG meeting 13 July 2015 – Agenda paper no. 40]

See the response to Question 10-10 in section 10.5.1.

Question 7-18: If an entity begins activities on a specifically anticipated contract either: (1) before it agrees to the contract with the customer; or (2) before the arrangement meets the criteria to be considered a contract under the standard, how would revenue for those activities be recognised at the date a contract exists? [TRG meeting 30 March 2015 – Agenda paper no. 33]

TRG members generally agreed that if the goods or services that ultimately will be transferred meet the criteria to be recognised over time, revenue would be recognised on a cumulative catch-up basis at the 'contract establishment date', reflecting the performance obligation(s) that are partially or fully satisfied at that time. The TRG agenda paper noted that the cumulative catch-up method is considered to be consistent with the overall principle of the standard that revenue is recognised when (or as) an entity transfers control of goods or services to a customer.

When recording revenue on a cumulative catch-up basis in these circumstances, an entity needs to consider the requirements in Step 5 of the model to determine the goods or services that the customer controls. This determines what portion of costs incurred before the contract establishment date would be included in any measure of progress used to calculate the cumulative catch-up adjustment. If, for example, costs incurred prior to the contract establishment date relate to uninstalled materials or any goods or services that the customer does not control, the inclusion of those costs in determining how much revenue to recognise might not be appropriate (see section 7.1.4.B for further discussion on uninstalled materials).

Question 7-19: How should an entity account for fulfilment costs incurred prior to the contract establishment date that are outside the scope of another standard (e.g., IAS 2)? [TRG meeting 30 March 2015 - Agenda paper no. 33]

See the response to Question 9-13 in section 9.3.2.

7.2 Control transferred at a point in time (updated September 2019)

For performance obligations in which control is not transferred over time, control is transferred as at a point in time. In many situations, the determination of *when* that point in time occurs is relatively straightforward. However, in other circumstances, this determination is more complex.

To help entities determine the point in time when a customer obtains control of a particular good or service, the Board provided the following requirements:

Extract from IFRS 15

38. If a performance obligation is not satisfied over time in accordance with paragraphs 35–37, an entity satisfies the performance obligation at a point in time. To determine the point in time at which a customer obtains control of a promised asset and the entity satisfies a performance obligation, the entity shall consider the requirements for control in paragraphs 31–34. In addition, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:

(a) The entity has a present right to payment for the asset—if a customer is presently obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange.

(b) The customer has legal title to the asset—legal title may indicate which party to a contract has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. Therefore, the transfer of legal title of an asset may indicate that the customer has obtained control of the asset. If an entity retains legal title solely as protection against the customer's failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.

(c) The entity has transferred physical possession of the asset—the customer's physical possession of an asset may indicate that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset or to restrict the access of other entities to those benefits. However, physical possession may not coincide with control of an asset. For example, in some repurchase agreements and in some consignment arrangements, a customer or consignee may have physical possession of an asset that the entity controls. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of an asset that the customer controls. Paragraphs B64–B76, B77–B78 and B79–B82 provide guidance on accounting for repurchase agreements, consignment arrangements and bill-and-hold arrangements, respectively.

Extract from IFRS 15 (cont'd)

(d) The customer has the significant risks and rewards of ownership of the asset—the transfer of the significant risks and rewards of ownership of an asset to the customer may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. However, when evaluating the risks and rewards of ownership of a promised asset, an entity shall exclude any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset. For example, an entity may have transferred control of an asset to a customer but not yet satisfied an additional performance obligation to provide maintenance services related to the transferred asset.

(e) The customer has accepted the asset—the customer's acceptance of an asset may indicate that it has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. To evaluate the effect of a contractual customer acceptance clause on when control of an asset is transferred, an entity shall consider the guidance in paragraphs B83–B86.

None of the indicators above are meant to individually determine whether the customer has gained control of the good or service. For example, while shipping terms may provide information about when legal title to a good transfers to the customer, they are not determinative when evaluating the point in time at which the customer obtains control of the promised asset. See Question 7-20 below for further discussion on shipping terms. An entity must consider all relevant facts and circumstances to determine whether control has transferred. The IASB also made it clear that the indicators are not meant to be a checklist. Furthermore, not all of them must be present for an entity to determine that the customer has gained control. Rather, the indicators are factors that are often present when a customer has obtained control of an asset and the list is meant to help entities apply the principle of control.[317]

IFRS 15.38 also states that indicators of control transfer are not limited to those listed above. For example, channel stuffing is a practice that entities sometimes use to increase sales by inducing distributors or resellers to buy substantially more goods than can be promptly resold. To induce the distributors to make such purchases, an entity may offer deep discounts that it would have to evaluate as variable consideration in estimating the transaction price (see section 5.2). Channel stuffing also may be accompanied by side agreements with the distributors that provide a right of return for unsold goods that is in excess of the normal sales return privileges offered by the entity. Significant increases in, or excess levels of, inventory in a distribution channel due to channel stuffing may affect or preclude the ability to conclude that control of such goods has transferred. Entities need to carefully consider the expanded rights of returns offered to customers in connection with channel stuffing in order to determine whether they prevent the entity from recognising revenue at the time of the sales transaction.

If an entity uses channel stuffing practices, it should consider whether disclosure in its financial statements is required when it expects these practices to materially affect future operating results. For example, if an entity sold excess levels into a certain distribution channel at, or near, the end of a reporting period, it is likely that those sales volumes would not be sustainable in future periods. That is, sales into that channel may, in fact, slow down in future

[317] IFRS 15.BC155.

periods as the excess inventory takes longer to entirely sell through the channel. In such a case, the entity should consider whether disclosure of the effect of the channel stuffing practice on its current and future earnings is required, if material.

In determining when control transfers, it is important that the entity consider the good or service it is transferring, not the right to obtain that good or service in the future. In its March 2018 meeting, the IFRS IC noted that the right to sell (or pledge) a right to obtain an asset (e.g., real estate) in the future is not evidence of control of the asset itself (see Question 7-3 in section 7.1.2 and Question 7-10 in section 7.1.3 for further discussion).[318]

We discuss the indicators in IFRS 15.38 that an entity considers when determining when it transfers control of the promised good or service to the customer in more detail below.

Present right to payment for the asset

As noted in the Basis for Conclusions, the IASB considered, but rejected specifying a right to payment as an overarching criterion for determining when revenue would be recognised. Therefore, while the date at which the entity has a right to payment for the asset may be an indicator of the date the customer obtained control of the asset, it does not always indicate that the customer has obtained control of the asset.[319] For example, in some contracts, a customer is required to make a non-refundable upfront payment, but receives no goods or services in return at that time.

Legal title and physical possession

The term 'title' is often associated with a legal definition denoting the ownership of an asset or legally recognised rights that preclude others' claim to the asset. Accordingly, the transfer of title often indicates that control of an asset has been transferred. Determination of which party has title to an asset does not always depend on which party has physical possession of the asset, but without contractual terms to the contrary, title generally passes to the customer at the time of the physical transfer. For example, in a retail store transaction, there is often no clear documentation of the transfer of title. However, it is generally understood that the title to a product is transferred at the time it is purchased by the customer.

While the retail store transaction is relatively straightforward, determining when title has transferred may be more complicated in other arrangements. Transactions that involve the shipment of products may have varying shipping terms and may involve third-party shipping agents. In such cases, a clear understanding of the seller's practices and the contractual terms is required in order to make an assessment of when title transfers. As indicated in IFRS 15.38(b), legal title and/or physical possession may be an indicator of which party to a contract has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. See Question 7-20 for further discussion on how shipping terms affect when an entity has transferred control of a good to a customer.

[318] *IFRIC Update*, March 2018, available on the IASB's website.
[319] IFRS 15.BC148.

Risks and rewards of ownership

Although the Board included the risks and rewards of ownership as one factor to consider when evaluating whether control of an asset has transferred, it emphasised, in the Basis for Conclusions, that this factor does not change the principle of determining the transfer of goods or services on the basis of control.[320] The concept of the risks and rewards of ownership is based on how the seller and the customer share both the potential gain (the reward) and the potential loss (risk) associated with owning an asset. Rewards of ownership include the following:

- Rights to all appreciation in value of the asset
- Unrestricted usage of the asset
- Ability to modify the asset
- Ability to transfer or sell the asset
- Ability to grant a security interest in the asset

Conversely, the risks of ownership include the following:

- Absorbing all of the declines in market value
- Incurring losses due to theft or damage of the asset
- Incurring losses due to changes in the business environment (e.g., obsolescence, excess inventory, effect of retail pricing environment)

However, as noted in IFRS 15.38(d), an entity does not consider risks that give rise to a separate performance obligation when evaluating whether the entity has the risks of ownership of an asset. For example, an entity does not consider warranty services that represent a separate performance obligation when evaluating whether it retains the risks of ownership of the asset sold to the customer.

Customer acceptance

See the discussion of this indicator in section 7.2.1.

[320] IFRS 15.BC154.

Example

The following example illustrates application of the indicators of the transfer of control in IFRS 15.38 to a performance obligation that is satisfied at a point in time:

Illustration 7-2 — Applying the indicators of the transfer of control to a performance obligation satisfied at a point in time

BCB Liquors (BCB) uses a distribution network to sell its product to end-consumers. Upon receipt of the product, a distributor receives legal title to the goods and is required to pay BCB for the product. In this example, BCB has determined its relationship with the distributor is not a consignment agreement (see section 7.4). Rather, the distributor is BCB's customer.

BCB determines that its performance obligation for the sale of product to the distributor is satisfied at a point in time. BCB considers the indicators of the transfer of control and concludes that control transfers to the distributor when the product is delivered to the distributor. At this point in time, BCB has a present right to payment and the distributor has legal title and physical possession of the product, as well as the risks and rewards of ownership. BCB concludes customer acceptance is a formality as BCB can objectively determine that the goods meet the agreed-upon specifications before shipment to the distributor.

Alternatively, if BCB sold the product to the distributor on consignment or determined that the end-consumer was its customer, the distributor was not obligated to pay for the product until it was sold to the end-consumer and BCB had the ability to require the return of any unsold product or the distributor had an unlimited amount of time to return any unsold products, then BCB may have concluded that control of the product would not transfer until it is sold to the end-consumer. Therefore, BCB would not recognise revenue until the product was sold to the end-consumer.

Frequently asked questions

Question 7-20: How do shipping terms affect when an entity has transferred control of a good to a customer?

Under the standard, an entity recognises revenue only when it satisfies an identified performance obligation by transferring a promised good or service to a customer. While shipping terms may provide information about when legal title to a good transfers to the customer, they are not determinative when evaluating the point in time at which the customer obtains control of the promised asset. Entities must consider all relevant facts and circumstances to determine whether control has transferred.

For example, when the shipping terms are free on board (FOB), entities need to carefully consider whether the customer or the entity has the ability to control the goods during the shipment period. Furthermore, if the entity has the legal or constructive obligation to replace goods that are lost or damaged in transit, it needs to evaluate whether that obligation influences the customer's ability to direct the use, and obtain substantially all of the remaining benefits from, the goods. A selling entity's historical practices also need to be considered when evaluating whether control of a good has transferred to a customer because the entity's practices may override the contractual terms of the arrangement.

Frequently asked questions (cont'd)

Contractually specified shipping terms may vary depending on factors such as the mode of transport (e.g., by sea, inland waterway, road, air) and whether the goods are shipped locally or internationally. A selling entity may utilise International Commerce Terms (Incoterms®) to clarify when delivery occurs. Incoterms® are a series of pre-defined commercial terms published by the International Chamber of Commerce (ICC) relating to international commercial law. For example, 'EXW' or 'Ex Works' in Incoterms® 2010 means that the selling entity 'delivers' when it places the goods at the disposal of the customer, either at the seller's premises or at another named location (e.g., a factory, warehouse). The selling entity is not required to load the goods on any collecting vehicle, nor does it need to clear the goods for export (if applicable, see further discussion on Ex Works in section 7.5). The Incoterm FOB means "the seller delivers the goods on board the vessel nominated by the buyer at the named port of shipment or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel, and the buyer bears all costs from that moment onwards".[321]

7.2.1 Customer acceptance (updated October 2018)

When determining whether the customer has obtained control of the goods or services, an entity must consider any customer acceptance clauses that require the customer to approve the goods or services before it is obliged to pay for them. If a customer does not accept the goods or services, the entity may not be entitled to consideration, may be required to take remedial action or may be required to take back the delivered good.

The standard provides the following application guidance regarding how to evaluate customer acceptance provisions:

Extract from IFRS 15

B84. If an entity can objectively determine that control of a good or service has been transferred to the customer in accordance with the agreed-upon specifications in the contract, then customer acceptance is a formality that would not affect the 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 confirmation of 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-upon specifications in the contract. If revenue is recognised before customer acceptance, the entity still must consider whether there are any remaining performance obligations (for example, installation of equipment) and evaluate whether to account for them separately.

[321] See the ICC website for further information.

Extract from IFRS 15 (cont'd)

B85. However, if an entity cannot objectively determine that the good or service provided to the customer is in accordance with the agreed-upon 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 in that circumstance the entity cannot determine that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service.

B86. If an entity delivers products to a customer for trial or evaluation purposes and the customer is not committed to pay any consideration until the trial period lapses, control of the product is not transferred to the customer until either the customer accepts the product or the trial period lapses.

Some acceptance provisions may be straightforward, giving a customer the ability to accept or reject the transferred products based on objective criteria specified in the contract (e.g., the goods function at a specified speed). Other acceptance clauses may be subjective or may appear in parts of the contract that do not typically address acceptance matters, such as warranty provisions or indemnification clauses. Professional judgement may be required to determine the effect on revenue recognition of the latter types of acceptance clauses.

Acceptance criteria that an entity cannot objectively evaluate against the agreed-upon specifications in the contract preclude an entity from concluding that a customer has obtained control of a good or service until formal customer sign-off is obtained or the acceptance provisions lapse. However, the entity would consider its experience with other contracts for similar goods or services because that experience may provide evidence about whether the entity is able to objectively determine that a good or service provided to the customer is in accordance with the agreed-upon specifications in the contract. We believe one or more of the following would represent circumstances in which the entity may not be able to objectively evaluate the acceptance criteria:

- The acceptance provisions are unusual or 'non-standard'. Indicators of 'non-standard' acceptance terms are:
  - The duration of the acceptance period is longer than in contracts for similar goods or services.
  - The majority of the entity's contracts lack similar acceptance terms.
  - The contract contains explicit customer-specified requirements that must be met prior to acceptance.
- The contract contains a requirement for explicit notification of acceptance (not just deemed acceptance). Explicit notification requirements may indicate that the criteria with which the customer is assessing compliance are not objective. In addition, such explicit notification clauses may limit the time period within which the customer can reject transferred products and may require the customer to provide, in writing, the reasons for the rejection of the products by the end of a specified period. When such clauses exist, acceptance can be deemed to have occurred at the end of the specified time period if notification of rejection has not been received from the customer, as long as the customer has not indicated it will reject the products.

In determining whether compliance with the criteria for acceptance can be objectively assessed (and acceptance is only a formality), the following should be considered:

- Whether the acceptance terms are standard in arrangements entered into by the entity.
- Whether the acceptance is based on the transferred product performing to standard, published, specifications and whether the entity can demonstrate that it has an established history of objectively determining that the product functions in accordance with those specifications.

As discussed above, customer acceptance should not be deemed a formality if the acceptance terms are unusual or non-standard. If a contract contains acceptance provisions that are based on customer-specified criteria, it may be difficult for the entity to objectively assess compliance with the criteria and the entity may not be able to recognise revenue prior to obtaining evidence of customer acceptance. However, determining that the acceptance criteria have been met (and, therefore, acceptance is merely a formality) may be appropriate if the entity can demonstrate that its product meets all of the customer's acceptance specifications by replicating, before shipment, those conditions under which the customer intends to use the product.

If it is reasonable to expect that the product's performance (once it has been installed and is operating at the customer's facility) will be different from the performance when it was tested prior to shipment, this acceptance provision will not have been met. The entity, therefore, would not be able to conclude that the customer has obtained control until customer acceptance occurs. Factors indicating that specifications cannot be tested effectively prior to shipment include:

- The customer has unique equipment, software or environmental conditions that can reasonably be expected to make performance in that customer's environment different from testing performed by the entity. If the contract includes customer acceptance criteria or specifications that cannot be effectively tested before delivery or installation at the customer's site, revenue recognition would be deferred until it can be demonstrated that the criteria are met.
- The products that are transferred are highly complex.
- The entity has a limited history of testing products prior to control transferring to the customer or a limited history of having customers accept products that it has previously tested.

Determining when a customer obtains control of an asset in a contract with customer-specified acceptance criteria requires the use of professional judgement and depends on the weight of the evidence in the particular circumstances. The conclusion could change based on an analysis of an individual factor, such as the complexity of the equipment, the nature of the interface with the customer's environment, the extent of the entity's experience with this type of transaction or a particular clause in the agreement. An entity may need to discuss the situation with knowledgeable project managers or engineers in making such an assessment.

In addition, each contract containing customer-specified acceptance criteria may require a separate compliance assessment of whether the acceptance provisions have been met prior to confirmation of the customer's acceptance. That is, since different customers may specify different acceptance criteria, an entity may not be able to make one compliance assessment that applies to all contracts because of the variations in contractual terms and customer environments.

Even if a contract includes a standard acceptance clause, if the clause relates to a new product or one that has only been sold on a limited basis previously, an entity may be required to initially defer revenue recognition for the product until it establishes a history of successfully obtaining acceptance.

IFRS 15.B86 states that, if an entity delivers products to a customer for trial or evaluation purposes and the customer is not committed to pay any consideration until the trial period lapses, control of the product is not transferred to the customer until either the customer accepts the product or the trial period lapses. See further discussion of 'free' trial periods in Question 3-2 in section 3.1, including when such arrangements may meet the criteria to be considered a contract within the scope of the model in IFRS 15.

7.3 Repurchase agreements

Some agreements include repurchase provisions, either as part of a sales contract or as a separate contract that relates to the goods in the original agreement or similar goods. These provisions affect how an entity applies the requirements on control to affected transactions.

The standard clarifies the types of arrangements that qualify as repurchase agreements:

Extract from IFRS 15

B64. A repurchase agreement is a contract in which an entity sells an asset and also promises or has the option (either in the same contract or in another contract) to repurchase the asset. 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.

B65. Repurchase agreements generally come in three forms:

(a) an entity's obligation to repurchase the asset (a forward);

(b) an entity's right to repurchase the asset (a call option); and

(c) an entity's obligation to repurchase the asset at the customer's request (a put option).

In order for an obligation or right to purchase an asset to be accounted for as a repurchase agreement under IFRS 15, it needs to exist at contract inception, either as a part of the same contract or in another contract. The IASB clarified that an entity's subsequent decision to repurchase an asset (after transferring control of that asset to a customer) without reference to any pre-existing contractual right would not be accounted for as a repurchase agreement under the standard. That is, the customer is not obliged to resell that good to the entity as a result of the initial contract. Therefore, any subsequent decision to repurchase the asset does not affect the customer's ability to control the asset upon initial transfer. However, in cases in which an entity decides to repurchase a good after transferring control of the good to a customer, the Board observed that the entity should carefully consider whether the customer obtained control in the initial transaction. Furthermore, it may need to consider the application guidance on principal versus agent considerations (see section 4.4).[322]

[322] IFRS 15.BC423.

7.3.1 Forward or call option held by the entity (updated September 2019)

When an entity has the obligation or right to repurchase an asset (i.e., a forward or a call option), the standard indicates that the customer has not obtained control of the asset. The standard provides the following application guidance:

Extract from IFRS 15

B66. If an entity has an obligation or a right to repurchase the asset (a forward or a call option), a customer does not obtain control of the asset because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though the customer may have physical possession of the asset. Consequently, the entity shall account for the contract as either of the following:

(a) a lease in accordance with IFRS 16 *Leases* if the entity can or must repurchase the asset for an amount that is less than the original selling price of the asset, unless the contract is part of a sale and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity shall continue to recognise the asset and shall recognise a financial liability for any consideration received from the customer. The entity shall account for the financial liability in accordance with IFRS 9; or

(b) a financing arrangement in accordance with paragraph B68 if the entity can or must repurchase the asset for an amount that is equal to or more than the original selling price of the asset.

B67. When comparing the repurchase price with the selling price, an entity shall consider the time value of money.

The application guidance, in the extract above, requires that an entity account for a transaction including a forward or a call option based on the relationship between the repurchase price and the original selling price. The standard indicates that if the entity has the right or obligation to repurchase the asset at a price less than the original sales price (taking into consideration the effects of the time value of money), the entity would account for the transaction as a lease in accordance IFRS 16, unless the contract is part of a sale and leaseback transaction. For additional information on lease accounting under IFRS 16, see our publication, *Applying IFRS: A closer look at the new leases standard*.[323] If the entity has the right or obligation to repurchase the asset at a price equal to or greater than the original sales price (considering the effects of the time value of money) or if the contract is part of a sale and leaseback transaction, the entity would account for the contract as a financing arrangement, as discussed below.

The following graphic depicts this application guidance for transactions that are not sale and leaseback transactions:

Forward or call option				
Repurchase price	<	Original selling price	=	Lease
Repurchase price	≥	Original selling price	=	Financing

[323] Latest version of this publication is available at ey.com/IFRS.

Under the standard, a transaction in which a seller has an option to repurchase the product is treated as a lease or a financing arrangement (i.e., not a sale). This is because the customer does not have control of the product and is constrained in its ability to direct the use of and obtain substantially all of the remaining benefits from the good. The Board noted in the Basis for Conclusions that entities would not need to consider the likelihood that a call option will be exercised in determining the accounting for the repurchase provision. However, the Board also stated that non-substantive call options are ignored and would not affect when a customer obtains control of an asset.[324] See Question 7-21 below for how an entity might consider conditional call options and an example of a conditional call option that may qualify to be treated as a sale.

In the Basis for Conclusions, the Board also observed that, "Theoretically, a customer is not constrained in its ability to direct the use of and obtain substantially all of the benefits from, the asset if an 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."[325] That is, in such a situation, a customer could sell the original asset (thereby exhibiting control over it) and then re-obtain a similar asset in the market place prior to the asset being repurchased by the entity.

If a transaction is considered a financing arrangement under the IFRS 15, the selling entity continues to recognise the asset. In addition, it records a financial liability for the consideration received from the customer. The difference between the consideration received from the customer and the consideration subsequently paid to the customer (upon repurchasing the asset) represents the interest and holding costs (as applicable) that are recognised over the term of the financing arrangement. If the option lapses unexercised, the entity derecognises the liability and recognises revenue at that time.

Also note that IFRS 15.B66(a) specifies that, if the contract is part of a sale and leaseback transaction, the entity continues to recognise the asset. Furthermore, the entity recognises a financial liability for any consideration received from the customer to which IFRS 9 would apply.

How we see it

Entities may find the requirements challenging to apply in practice as the standard treats all forwards and call options the same way and does not consider the likelihood that they will be exercised. In addition, since the standard provides lease requirements, it is important for entities to understand the interaction between the lease and revenue standards.

[324] IFRS 15.BC427.
[325] IFRS 15.BC425.

The standard provides the following example of a call option:

Extract from IFRS 15

Example 62 — Repurchase agreements (IFRS 15.IE315-IE318)

An entity enters into a contract with a customer for the sale of a tangible asset on 1 January 20X7 for CU1 million.

Case A—Call option: financing

The contract includes a call option that gives the entity the right to repurchase the asset for CU1.1 million on or before 31 December 20X7.

Control of the asset does not transfer to the customer on 1 January 20X7 because the entity has a right to repurchase the asset and therefore the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Consequently, in accordance with paragraph B66(b) of IFRS 15, the entity accounts for the transaction as a financing arrangement, because the exercise price is more than the original selling price. In accordance with paragraph B68 of IFRS 15, the entity does not derecognise the asset and instead recognises the cash received as a financial liability. The entity also recognises interest expense for the difference between the exercise price (CU1.1 million) and the cash received (CU1 million), which increases the liability.

On 31 December 20X7, the option lapses unexercised; therefore, the entity derecognises the liability and recognises revenue of CU1.1 million.

Frequently asked questions

Question 7-21: How can an entity evaluate a conditional call option to repurchase an asset?

The standard does not specifically address conditional call options. We believe that if the entity controls the outcome of the condition that causes the call option to become active, then the presence of the call option indicates that control has not transferred because the customer is limited in its ability to direct the use of and obtain substantially all of the remaining benefits from the asset. That is, the entity would be required to treat the contract as a lease or a financing arrangement as required by IFRS 15.B66.

We also believe that if the entity does not control the condition that causes the call option to become active, then it would be acceptable for the entity to apply judgement to determine whether the call option limits the customer's ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. For example, if neither the entity nor the customer controls the outcome of the contingency, the entity could evaluate the nature of the contingency, together with the likelihood of the contingency becoming active, to determine whether it limits the customer's ability to obtain control of the asset.

Furthermore, we believe that if the customer controls the outcome of the contingency, then the conditional call option may not prevent the customer from obtaining control of the asset if the customer can direct the use of, and obtain substantially all the remaining benefits from, the asset. The application guidance in IFRS 15.B70-B76 may be helpful for an entity to consider when determining whether the customer obtains control of the asset when it controls the outcome of the contingency.

Frequently asked questions (cont'd)

In the case of perishable products, we believe that an entity's conditional right to remove and replace expired goods does not necessarily constrain the customer's ability to direct the use of and obtain substantially all of the remaining benefits from the products. That is, the entity is not able to remove and replace the products until they expire. Furthermore, the customer has control of the products over their entire useful life. Consequently, it may be reasonable for an entity to conclude that control of the initial product does transfer to the customer in this situation and that an entity could consider this right to be a form of a right of return (see section 5.4).

7.3.2 Put option held by the customer

IFRS 15 indicates that if the customer has the ability to require an entity to repurchase an asset (i.e., a put option) at a price lower than its original selling price, the entity considers, at contract inception, whether the customer has a significant economic incentive to exercise that right. That is, this determination influences whether the customer truly has control over the asset received.

The determination of whether an entity has a significant economic incentive to exercise its right determines whether the arrangement is treated as a lease or a sale with the right of return (discussed in section 5.4). An entity must consider all relevant facts and circumstances to determine whether a customer has a significant economic incentive to exercise its right, including the relationship between the repurchase price to the expected market value (taking into consideration the effects of the time value of money) of the asset at the date of repurchase and the amount of time until the right expires. The standard notes that if the repurchase price is expected to significantly exceed the market value of the asset, the customer may have a significant economic incentive to exercise the put option:

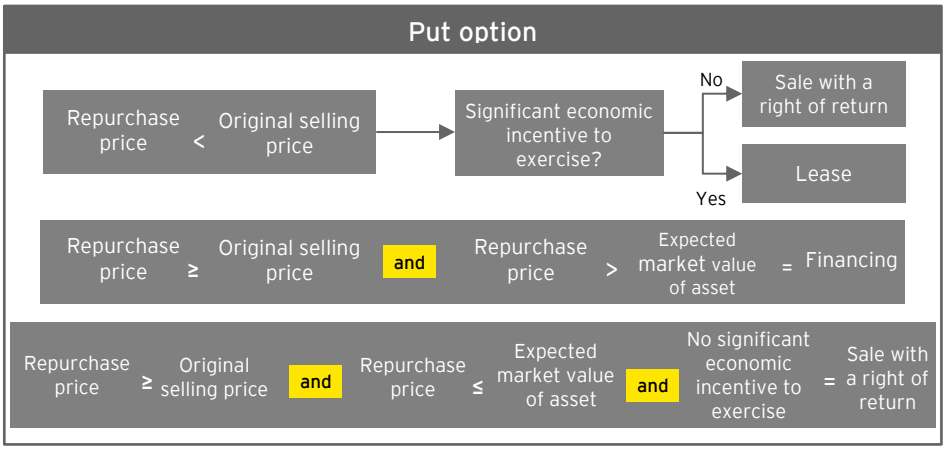
- If a customer has a significant economic incentive to exercise its right, the customer is expected to ultimately return the asset. The entity accounts for the agreement as a lease because the customer is effectively paying the entity for the right to use the asset for a period of time. However, one exception to this would be if the contract is part of a sale and leaseback, in which case, the contract would be accounted for as a financing arrangement. If the contract is part of a sale and leaseback transaction, the entity continues to recognise the asset. Furthermore, the entity recognises a financial liability for any consideration received from the customer to which IFRS 9 would apply.
- If a customer does not have a significant economic incentive to exercise its right, the entity accounts for the agreement in a manner similar to a sale of a product with a right of return.

The repurchase price of an asset that is equal to or greater than the original selling price, but less than or equal to the expected market value of the asset, must also be accounted for as a sale of a product with a right of return, if the customer does not have a significant economic incentive to exercise its right. See section 5.4 for a discussion on sales with a right of return.

If the customer has the ability to require an entity to repurchase the asset at a price equal to, or more than, the original selling price and the repurchase price is more than the expected market value of the asset, the contract is in effect a financing arrangement.

If the option lapses unexercised, an entity derecognises the liability and recognises revenue.

The following graphic depicts this application guidance:



How we see it

IFRS 15 does not provide any guidance on determining whether 'a significant economic incentive' exists and judgement may be required to make this determination.

The standard provides the following example of a put option:

Extract from IFRS 15

Example 62 — Repurchase agreements (IFRS 15.IE315, IE319-IE321)

An entity enters into a contract with a customer for the sale of a tangible asset on 1 January 20X7 for CU1 million.

Case B—Put option: lease

Instead of having a call option, the contract includes a put option that obliges the entity to repurchase the asset at the customer's request for CU900,000 on or before 31 December 20X7. The market value is expected to be CU750,000 on 31 December 20X7.

At the inception of the contract, the entity assesses whether the customer has a significant economic incentive to exercise the put option, to determine the accounting for the transfer of the asset (see paragraphs B70-B76 of IFRS 15). The entity concludes that the customer has a significant economic incentive to exercise the put option because the repurchase price significantly exceeds the expected market value of the asset at the date of repurchase. The entity determines there are no other relevant factors to consider when assessing whether the customer has a significant economic incentive to exercise the put option. Consequently, the entity concludes that control of the asset does not transfer to the customer, because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

In accordance with paragraphs B70-B71 of IFRS 15, the entity accounts for the transaction as a lease in accordance with IFRS 16 *Leases*.

7.3.3 Sales with residual value guarantees

An entity that sells equipment may use a sales incentive programme under which it guarantees that the customer will receive a minimum resale amount when it disposes of the equipment (i.e., a residual value guarantee). If the customer holds a put option and has a significant economic incentive to exercise, the customer is effectively restricted in its ability to consume, modify or sell the asset. In contrast, when the entity guarantees that the customer will receive a minimum amount of sales proceeds, the customer is not constrained in its ability to direct the use of, and obtain substantially all of the benefits from, the asset. Accordingly, the Board decided that it was not necessary to expand the application guidance on repurchase agreements to consider guaranteed amounts of resale.[326]

Therefore, it is important for an entity to review all its contracts and make sure that the residual value guarantee is not accomplished through a repurchase provision, such as a put within the contract (e.g., the customer has the right to require the entity to repurchase equipment two years after the date of purchase at 85% of the original purchase price). If a put option is present, the entity would have to use the application guidance in the standard discussed in section 7.3.2 to determine whether the existence of the put option precludes the customer from obtaining control of the acquired item. In such circumstances, the entity would determine whether the customer has a significant economic incentive to exercise the put. If the entity concludes that there is no significant economic incentive, the transaction would be accounted for as a sale with a right of return. Alternatively, if the entity concludes there is a significant economic incentive for the customer to exercise its right, the transaction would be accounted for as a lease.

However, assume the transaction includes a residual value guarantee in which no put option is present. If the entity guarantees that it will compensate the customer (or 'make whole') on a qualifying future sale if the customer receives less than 85% of the initial sale price, the application guidance on repurchase agreements in IFRS 15 would not apply. That is because the entity is not repurchasing the asset.

In such situations, judgement is needed to determine the appropriate accounting treatment, which will depend on the specific facts and circumstances. In some cases, an entity may need to consider the requirements of other IFRSs to appropriately account for the residual value guarantee. In other situations, IFRS 15 may apply to the entire transaction. If IFRS 15 applies, an entity would need to assess whether the guarantee affects control of the asset transferring, which will depend on the promise to the customer. In some cases, it may not affect the transfer of control. In the Basis for Conclusions, the Board noted that "when the entity guarantees that the customer will receive a minimum amount of sales proceeds, the customer is not constrained in its ability to direct the use of, and obtain substantially all of the benefits from, the asset."[327] However, while a residual value guarantee may not affect the transfer of control, an entity would need to consider whether it affects the transaction price (see section 5). While the economics of a repurchase agreement and a residual value guarantee may be similar, the accounting could be quite different.

[326] IFRS 15.BC427.
[327] IFRS 15.BC431.

7.4 Consignment arrangements (updated October 2018)

Entities frequently deliver inventory on a consignment basis to other parties (e.g., distributor, dealer). A consignment sale is one in which physical delivery of a product to a counterparty has occurred, but the counterparty is not required to pay until the product is either resold to an end customer or used by the counterparty. Under such arrangements, the seller (or consignor) retains the legal title to the merchandise and the counterparty (or consignee) acts as a selling agent. The consignee earns a commission on the products that have been sold and periodically remits the cash from those sales, net of the commission it has earned, to the consignor. In addition, consigned products that are not sold or used generally can be returned to the consignor. By shipping on a consignment basis, consignors are able to better market products by moving them closer to the end-customer. However, they do so without selling the goods to the intermediary (consignee).

The standard provides the following application guidance for determining whether an arrangement is a consignment arrangement:

Extract from IFRS 15

B78. Indicators that an arrangement is a consignment arrangement include, but are not limited to, the following:

(a) the product is controlled 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;

(b) the entity is able to require the return of the product or transfer the product to a third party (such as another dealer); and

(c) the dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).

Entities entering into a consignment arrangement need to determine the nature of the performance obligation (i.e., whether the obligation is to transfer the product to the consignee or to transfer the product to the end-customer). This determination would be based on whether control of the product passes to the consignee. Typically, a consignor does not relinquish control of the consigned product until the product is sold to the end-customer or, in some cases, when a specified period expires. Consignees commonly do not have any obligation to pay for the product, other than to pay the consignor the agreed-upon portion of the sale price once the consignee sells the product to a third party. As a result, for consignment arrangements, revenue generally would not be recognised when the products are delivered to the consignee because control has not transferred (i.e., the performance obligation to deliver goods to the end-customer has not yet been satisfied).

While some transactions are clearly identified as consignment arrangements, there are other less transparent transactions, in which the seller has retained control of the goods, despite no longer having physical possession. Such arrangements may include the shipment of products to distributors that are not required (either explicitly or implicitly), or do not have the wherewithal, to pay for the product until it is sold to the end-customer. Judgement is necessary in assessing whether the substance of a transaction is a consignment arrangement. The identification of such arrangements often requires a careful analysis of the facts and circumstances of the transaction, as well as an understanding of the rights and obligations of the parties and the seller's customary business practices in such arrangements. While not required by

IFRS 15 or IAS 2, we would encourage entities to separately disclose the amount of their consigned inventory, if material.

7.5 Bill-and-hold arrangements (updated October 2018)

In some sales transactions, the selling entity fulfils its obligations and bills the customer for the work performed, but does not ship the goods until a later date. These transactions, often called bill-and-hold transactions, are usually designed this way at the request of the purchaser for a number of reasons, including a lack of storage capacity or an inability to use the goods until a later date. Whereas in a consignment sale (discussed above in section 7.4), physical delivery has occurred, but control of the goods has not transferred to the customer, the opposite may be true in a bill-and-hold transaction.

The standard provides the following application guidance with respect to these arrangements:

Extract from IFRS 15

B79. A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future. For example, a customer may request an entity to enter into such a contract because of the customer's lack of available space for the product or because of delays in the customer's production schedules.

B80. An entity shall determine when it has satisfied its performance obligation to transfer a product by evaluating when a customer obtains control of that product (see paragraph 38). For some contracts, control is transferred either when the product is delivered to the customer's site or when the product is shipped, depending on the terms of the contract (including delivery and shipping terms). However, for some contracts, a customer may obtain control of a product even though that product remains in an entity's physical possession. In that case, the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the product even though it has decided not to exercise its right to take physical possession of that product. Consequently, the entity does not control the product. Instead, the entity provides custodial services to the customer over the customer's asset.

B81. In addition to applying the requirements in paragraph 38, for a customer to have obtained control of a product in a bill-and-hold arrangement, all of the following criteria must be met:

(a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);

(b) the product must be identified separately as belonging to the customer;

(c) the product currently must be ready for physical transfer to the customer; and

(d) the entity cannot have the ability to use the product or to direct it to another customer.

B82. If an entity recognises revenue for the sale of a product on a bill-and-hold basis, the entity shall consider whether it has remaining performance obligations (for example, for custodial services) in accordance with paragraphs 22–30 to which the entity shall allocate a portion of the transaction price in accordance with paragraphs 73–86.

When evaluating whether revenue recognition is appropriate for a bill-and-hold transaction, an entity must evaluate the application guidance in both IFRS 15.38 (to determine whether control has been transferred to the customer – see section 7.2) and IFRS 15.B81 (to determine whether all four bill-and-hold criteria are met). That is, in addition to IFRS 15.38, the criteria that must be met for bill-and-hold transactions are:

- *The reason for the bill-and-hold arrangement must be substantive (e.g., the customer has requested the arrangement).* A bill-and-hold transaction initiated by the selling entity typically indicates that a bill-and-hold arrangement is not substantive. We would generally expect the customer to request such an arrangement and the selling entity would need to evaluate the reasons for the request to determine whether the customer has a substantive business purpose. Judgement is required when assessing this criterion. For example, a customer with an established buying history that places an order in excess of its normal volume and requests that the entity retains the product needs to be evaluated carefully because the request may not appear to have a substantive business purpose.
- *The product must be identified separately as belonging to the customer*. Even if the entity's inventory is homogenous, the customer's product must be segregated from the entity's ongoing fulfilment operations.
- *The product currently must be ready for physical transfer to the customer*. In any revenue transaction recognised at a point in time, revenue is recognised when an entity has satisfied its performance obligation to transfer control of the product to the customer. If an entity has remaining costs or effort to develop, manufacture or refine the product, the entity may not have satisfied its performance obligation. This criterion does not include the actual costs to deliver a product, which would be normal and customary in most revenue transactions, or if the entity identifies a separate performance obligation for custodial services, as discussed below.
- *The entity cannot have the ability to use the product or to direct it to another customer*. If the entity has the ability to freely substitute goods to fill other orders, control of the goods has not passed to the buyer. That is, the entity has retained the right to use the customer's product in a manner that best suits the entity.

If an entity concludes that it can recognise revenue for a bill-and-hold transaction, IFRS 15.B82 states that the entity needs to further consider whether it is also providing custodial services for the customer that would be identified as a separate performance obligation in the contract.

As discussed in Question 7-20 in section 7.2, certain entities may use Ex Works from Incoterms® 2010 in contracts with customers. Under an Ex Works arrangement, the entity's responsibility is to make ordered goods available to the customer at the entity's premises or another named location. The customer is responsible for arranging, and paying for, shipment of the goods to the desired location and bears all of the risks related to them once they are made available.

We believe that all Ex Works arrangements need to be evaluated using the bill-and-hold criteria discussed above to determine whether revenue recognition is appropriate prior to shipment.

The standard provides the following example to illustrate the application guidance on bill-and-hold arrangements:

Extract from IFRS 15

Example 63 — Bill-and-hold arrangement (IFRS 15.IE323-IE327)

An entity enters into a contract with a customer on 1 January 20X8 for the sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is two years.

Upon completion of manufacturing, the entity demonstrates that the machine and spare parts meet the agreed-upon specifications in the contract. The promises to transfer the machine and spare parts are distinct and result in two performance obligations that each will be satisfied at a point in time. On 31 December 20X9, the customer pays for the machine and spare parts, but only takes physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at the entity's warehouse because of its close proximity to the customer's factory. The customer has legal title to the spare parts and the parts can be identified as belonging to the customer.

Furthermore, the entity stores the spare parts in a separate section of its warehouse and the parts are ready for immediate shipment at the customer's request. The entity expects to hold the spare parts for two to four years and the entity does not have the ability to use the spare parts or direct them to another customer.

The entity identifies the promise to provide custodial services as a performance obligation because it is a service provided to the customer and it is distinct from the machine and spare parts. Consequently, the entity accounts for three performance obligations in the contract (the promises to provide the machine, the spare parts and the custodial services). The transaction price is allocated to the three performance obligations and revenue is recognised when (or as) control transfers to the customer.

Control of the machine transfers to the customer on 31 December 20X9 when the customer takes physical possession. The entity assesses the indicators in paragraph 38 of IFRS 15 to determine the point in time at which control of the spare parts transfers to the customer, noting that the entity has received payment, the customer has legal title to the spare parts and the customer has inspected and accepted the spare parts. In addition, the entity concludes that all of the criteria in paragraph B81 of IFRS 15 are met, which is necessary for the entity to recognise revenue in a bill-and-hold arrangement. The entity recognises revenue for the spare parts on 31 December 20X9 when control transfers to the customer.

The performance obligation to provide custodial services is satisfied over time as the services are provided. The entity considers whether the payment terms include a significant financing component in accordance with paragraphs 60–65 of IFRS 15.

7.6 Recognising revenue for licences of intellectual property

IFRS 15 provides application guidance for recognising revenue from licences of intellectual property that differs in some respects from the general requirements for other promised goods or services. We discuss licensing in detail in section 8.

7.7 Recognising revenue when a right of return exists

As discussed in section 4.7, a right of return does not represent a separate performance obligation. Instead, the existence of a right of return affects the transaction price and the entity must determine whether the customer will return the transferred product.

Under IFRS 15, as discussed in section 5, an entity estimates the transaction price and applies the constraint to the estimated transaction price. In doing so, it considers the products expected to be returned in order to determine the amount to which the entity expects to be entitled (excluding consideration for the products expected to be returned). The entity recognises revenue based on the amounts to which the entity expects to be entitled through to the end of the return period (considering expected product returns). An entity does not recognise the portion of the revenue that is subject to the constraint until the amount is no longer constrained, which could be at the end of the return period or earlier if the entity's expectations about the products expected to be returned change prior to the end of the return period. The entity recognises the amount received or receivable that is expected to be returned as a refund liability, representing its obligation to return the customer's consideration. An entity also updates its estimates at the end of each reporting period. See sections 4.7 and 5.4.1 for further discussion on this topic.

7.8 Recognising revenue for customer options for additional goods or services

As discussed in section 4.6, when an entity grants a customer the option to acquire additional goods or services, that option is a separate performance obligation if it provides a material right to the customer that the customer would not receive without entering into the contract (e.g., a discount that exceeds 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 to the customer, the customer has, in effect, paid the entity in advance for future goods or services. IFRS 15 requires the entity to allocate a portion of the transaction price to the material right at contract inception (see section 6.1.5). The revenue allocated to the material right is recognised when (or as) the option is exercised (and the underlying future goods or services are transferred) or when the option expires.

In contrast, if a customer option is not deemed to be a material right and is instead a marketing offer, the entity does not account for the option and waits to account for the underlying goods or services until those subsequent purchases occur.

Frequently asked questions

Question 7-22: How would an entity account for the exercise of a material right? That is, would an entity account for it as: a contract modification, a continuation of the existing contract or variable consideration? [TRG meeting 30 March 2015 - Agenda paper no. 32]

See response to Question 4-24 in section 4.6.

7.9 Breakage and prepayments for future goods or services (updated October 2018)

In certain industries, an entity collects non-refundable payments from its customers for goods or services that the customer has a right to receive in the future. However, a customer may ultimately leave that right unexercised (often referred to as 'breakage'). Retailers, for example, frequently sell gift cards that may not be partially redeemed or completely redeemed and airlines sometimes sell non-refundable tickets to passengers who allow the tickets to expire unused.

Under IFRS 15.B44, when an entity receives consideration that is attributable to a customer's unexercised rights, the entity recognises a contract liability equal to the full amount prepaid by the customer for the performance obligation to transfer, or to stand ready to transfer, goods or services in the future. As discussed further below, an entity derecognises that contract liability (and recognises revenue) when it transfers those goods or services and, therefore, satisfies its performance obligation. The Board noted that this application guidance requires the same pattern of revenue recognition as the requirements for customer options (see section 6.1.5).[328]

However, since entities may not be required by customers to fully satisfy their performance obligations, IFRS 15.B46 requires that when an entity expects to be entitled to a breakage amount, the expected breakage would be recognised as revenue in proportion to the pattern of rights exercised by the customer. If an entity does not expect to be entitled to a breakage amount, it would not recognise any breakage amounts as revenue until the likelihood of the customer exercising its right becomes remote.[329]

When estimating any breakage amount, an entity has to consider the constraint on variable consideration, as discussed in section 5.2.3. That is, if it is highly probable that a significant revenue reversal would occur for any estimated breakage amounts, an entity would not recognise those amounts until the breakage amounts are no longer constrained.

Entities cannot recognise estimated breakage as revenue immediately upon receipt of prepayment from the customer. The Board noted that it rejected such an approach because the entity has not performed under the contract. That is, recognising revenue would not be a faithful depiction of the entity's performance and would understate its obligation to stand ready to provide future goods or services.[330] This would be the case even if an entity has historical evidence to support the view that no further performance will be required for some portion of the customer contract(s).

Furthermore, in accordance with IFRS 15.B47, regardless of whether an entity can demonstrate the ability to reliably estimate breakage, entities would not estimate or recognise any amounts attributable to a customer's unexercised rights in income (e.g., an unused gift card balance) if the amounts are required to be remitted to another party (e.g., the government). Such an amount is recognised as a liability.

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[328] IFRS 15.BC398.
[329] IFRS 15.BC398.
[330] IFRS 15.BC400.

Consider the following example to illustrate how an entity would apply the above application guidance to the sale of a gift card that is within the scope of IFRS 15 (see Question 2-9 in 2.5 for further discussion):

Illustration 7-3 — Accounting for the sale of a gift card

Entity A sells a CU500 non-refundable gift card that can be redeemed at any of its retail locations. Any unused balance is not subject to laws that require from the entity to remit the payment to another party. When the gift card is sold, Entity A recognises a contract liability of CU500 (i.e., the full amount that was prepaid by the customer). No breakage is recognised as revenue upon sale of the gift card.

Scenario A – Entity expects to be entitled to a breakage amount

Based on historical redemption rates, Entity A expects 90% of the gift card (or CU450) to be redeemed. That is, Entity A expects breakage of 10% (or CU50). Upon its first use, the customer redeems CU225 of the gift card. That is, 50% of the expected redemption has occurred (i.e., CU225 redemption / CU450 total expected redemption). Upon this redemption, Entity A recognises revenue and reduces the contract liability by CU250. This is equal to CU225 for the transfer of goods or services purchased by the customer, as well as breakage of CU25 (50% redemption x CU50 breakage estimate) that is recognised in proportion to the exercise of the customer's rights. Similar accounting would occur for future redemptions.

Scenario B – Entity does not expect to be entitled to a breakage amount

Based on historical redemption experiences that customers fully redeem similar gift cards (or possibly the lack of historical experience due to a new gift card programme that means Entity A is unable to estimate the redemption rates), Entity A does not expect to be entitled to a breakage amount. Upon its first use of the gift card, the customer redeems CU225. Entity A recognises revenue and reduces the contract liability by the same amount as the redemption (or CU225). That is, no additional amounts are recognised for breakage. Similar accounting would occur for future redemptions.

If no further redemptions occur, Entity A recognises the remaining gift card balance (or CU275) as revenue (and reduces the contract liability by the same amount) when the likelihood of the customer exercising its remaining rights becomes remote.

As discussed above, the application guidance on breakage requires that an entity recognise a liability for the full amount of the prepayment. It would then recognise breakage on that liability proportionate to the pattern of rights exercised by the customer. If the prepayment element (e.g., the sale of a gift card, loyalty points) is part of a multiple-element arrangement, an entity needs to allocate the transaction price between the identified performance obligations. As a result, the deferred revenue associated with this element would be less than the 'prepaid' amount received for the unsatisfied performance obligations.

The following example depicts the sale of goods with loyalty points. In this example, the amount allocated to the points (i.e., the 'prepaid' element) is less than the stand-alone selling price of those points because of the allocation of the transaction price among the two performance obligations.

Extract from IFRS 15

Example 52 — Customer loyalty programme (IFRS 15.IE267-IE270)

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 of the entity's products. During a reporting period, customers purchase products for CU100,000 and earn 10,000 points that are redeemable for future purchases. The consideration is fixed and 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 (totalling CU9,500) on the basis of the likelihood of redemption in accordance with paragraph B42 of IFRS 15.

The points provide a material right to customers that they would not receive without entering into a contract. Consequently, the entity concludes that the promise to provide points to the customer is a performance obligation. The entity allocates the transaction price (CU100,000) to the product and the points on a relative stand-alone selling price basis as follows:

	CU	
Product	91,324	[CU100,000 × (CU100,000 stand-alone selling price ÷ CU109,500)]
Points	8,676	[CU100,000 × (CU9,500 stand-alone selling price ÷ CU109,500)]

At the end of the first reporting period, 4,500 points have been redeemed and the entity continues to expect 9,500 points to be redeemed in total. The entity recognises revenue for the loyalty points of CU4,110 [(4,500 points ÷ 9,500 points) × CU8,676] and recognises a contract liability of CU4,566 (CU8,676 – CU4,110) for the unredeemed points at the end of the first reporting period.

At the end of the second reporting period, 8,500 points have been redeemed cumulatively. The entity updates its estimate of the points that will be redeemed and now expects that 9,700 points will be redeemed. The entity recognises revenue for the loyalty points of CU3,493 {[(8,500 total points redeemed ÷ 9,700 total points expected to be redeemed) × CU8,676 initial allocation] – CU4,110 recognised in the first reporting period}. The contract liability balance is CU1,073 (CU8,676 initial allocation – CU7,603 of cumulative revenue recognised).

As depicted in Example 52 above (i.e., IFRS 15.IE269-IE270), entities need to routinely refine and evaluate estimates of breakage.

Frequently asked questions

Question 7-23: Are customers' unexercised rights (i.e., breakage) a form of variable consideration?

Although the breakage application guidance in IFRS 15.B46 specifically refers to the constraint on variable consideration, we do not believe breakage is a form of variable consideration (see section 5.2). This is because it does not affect the transaction price. Breakage is a recognition concept (Step 5) that could affect the timing of revenue recognition. It is not a measurement concept (Step 3). For example, the transaction price for a sale of a CU20 gift card is fixed at CU20 regardless of the expected breakage amount. The expected breakage, however, could affect the timing of revenue recognition because an entity is required under IFRS 15.B46 to "recognise the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer" if it expects to be entitled to a breakage amount.

Question 7-24: How should revenue be recognised for customer options for additional goods or services that represent a material right, but do not have an expiration date (i.e., can an entity recognise breakage for these options)?

See response to Question 4-26 in section 4.6.

8. Licences of intellectual property

IFRS 15 provides application guidance for recognising revenue from licences of intellectual property that differs in some respects from the requirements for other promised goods or services. Given that licences include a wide array of features and economic characteristics, the Board decided that an entity needs to evaluate the nature of its promise to grant a licence of intellectual property in order to determine whether the promise is satisfied (and revenue is recognised) over time or at a point in time. A licence provides either:

- A right to access the entity's intellectual property throughout the licence period, which results in revenue that is recognised over time

  Or

- A right to use the entity's intellectual property as it exists at the point in time in which the licence is granted, which results in revenue that is recognised at a point in time

IFRS 15.B52 provides examples of intellectual property that may be licensed to a customer, including software and technology, media and entertainment (e.g., motion pictures and music), franchises, patents, trademarks and copyrights.

The application guidance provided on licences of intellectual property is only applicable to licences that are distinct. When the licence is the only promised item (either explicitly or implicitly) in the contract, the application guidance is clearly applicable to that licence. The assessment as to whether the contract includes a distinct licence of intellectual property may be straightforward for many contracts. However, if there are multiple promises in a contract, entities may have to more carefully evaluate the nature of the rights conveyed.

Licences of intellectual property are frequently included in multiple-element arrangements with promises for additional goods or services that may be explicit or implicit. In these situations, an entity first applies the requirements of Step 2 of the model to determine whether the licence of intellectual property is distinct, as discussed in section 4 and section 8.1.

For most licences that are not distinct, an entity would follow the general requirements in Step 5 of the model to account for the recognition of revenue for the performance obligation that includes the licence (i.e., the requirements in IFRS 15.31-36 to determine whether the performance obligation transfers over time or at a point in time, as discussed in sections 7.1 and 7.2). Furthermore, the IASB noted in the Basis for Conclusions that there may be some situations in which, even though the licence is not distinct from the good or service transferred with the licence, the licence is the primary or dominant component (i.e., the predominant item) of the combined performance obligation.[331] In such situations, the IASB indicated that the application guidance for licences still applies. The Board provided no application guidance or bright lines for determining when a licence is the primary or dominant component. However, the IASB referred to an example in the Basis for Conclusions to illustrate this concept further.[332] See section 8.2.1 for further discussion. The determination of whether a licence is the predominant component may be obvious in some cases, but not in others. Therefore, entities may need to exercise significant judgement and consider both qualitative and quantitative factors.

[331] IFRS 15.BC407.
[332] IFRS 15.BC414X.

8.1 Identifying performance obligations in a licensing arrangement

Contracts for licences of intellectual property frequently include explicit or implicit promises for additional goods or services (e.g., equipment, when-and-if available upgrades, maintenance and installation). Consistent with Step 2 of the general model (see section 4), entities need to apply the requirements on identifying performance obligations in IFRS 15.22-30 when a contract with a customer includes a licence of intellectual property and other promised goods or services in order to appropriately determine whether the licence of intellectual property and the other promises are distinct (i.e., are separate performance obligations).

As discussed in section 4.2, the standard outlines a two-step process for determining whether a promised good or service (including a licence of intellectual property) is distinct and, therefore, is a performance obligation:

(a) Consideration of the individual good or service (i.e., whether the good or service is capable of being distinct)

And

(b) Consideration of whether the good or service is separately identifiable from other promises in the contract (i.e., whether the promise to transfer the good or service is distinct in the context of the contract)

To conclude that a good or service is distinct, an entity needs to determine that the good or service is both capable of being distinct and distinct in the context of the contract. These requirements need to be applied to determine whether a promise to grant a licence of intellectual property is distinct from other promised goods or services in the contract. Therefore, entities are required to assess whether the customer can benefit from a licence of intellectual property on its own or together with readily available resources (i.e., whether it is capable of being distinct) and whether the entity's promise to transfer a licence of intellectual property is separately identifiable from other promises in the contract (i.e., whether it is distinct in the context of the contract). The assessment of whether a licence of intellectual property is distinct needs to be based on the facts and circumstances of each contract.

8.1.1 Licences of intellectual property that are distinct

Licences are frequently capable of being distinct (i.e., the first criteria of a distinct good or service) as a customer can often obtain at least some benefit from the licence of intellectual property on its own or with other readily available resources. Consider Example 11, Case A, from the standard (extracted in full in section 4.2.3), which includes a contract for a software licence that is transferred along with installation services, technical support and unspecified software updates. The installation service is routinely performed by other entities and does not significantly modify the software. The software licence is delivered before the other goods or services and remains functional without the updates and technical support. The entity concludes that the customer can benefit from each of the goods or services either on their own or together with other goods or services that are readily available. That is, each good or service, including the software licence, is capable of being distinct under IFRS 15.27.

If an entity determines that a licence of intellectual property and other promised goods or services are capable of being distinct, the second step in the evaluation is to determine whether they are distinct in the context of the contract. As part of

this evaluation, an entity considers the indicators for whether the goods or services are not separately identifiable, including whether:

(1) The entity provides a significant service of integrating the licence and other goods or services into a combined output or outputs

(2) The licence and other goods or services significantly modify or customise each other

Or

(3) The licence and other goods or services are highly interdependent or highly interrelated, such that the entity would not be able to fulfil its promise to transfer the licence independently of fulfilling its promise to transfer the other goods or services to the customer

Continuing with Example 11, Case A, discussed above, the entity considers the separately identifiable principle and factors in IFRS 15.29 and determines that the promise to transfer each good and service, including the software licence, is separately identifiable. In reaching this determination, the entity considers that the installation services are routine and can be obtained from other providers. In addition, the entity considers that, although it integrates the software into the customer's system, the software updates do not significantly affect the customer's ability to use and benefit from the software licence during the licence period. Therefore, neither the installation services nor the software updates significantly affect the customer's ability to use and benefit from the software licence. The entity further observes that none of the promised goods or services significantly modify or customise one another and the entity is not providing a significant service of integrating the software and services into one combined output. Lastly, the software and the services are not deemed to be highly interdependent or highly interrelated because the entity would be able to fulfil its promise to transfer the initial software licence independent from its promise to subsequently provide the installation service, software updates and the technical support.

The following example from the standard also illustrates a contract for which a licence of intellectual property is determined to be distinct from other promised goods or services:

Extract from IFRS 15

Example 56 — Identifying a distinct licence (IFRS 15.IE281, IE285-IE288)

An entity, a pharmaceutical company, licenses to a customer its patent rights to an approved drug compound for 10 years and also promises to manufacture the drug for the customer. The drug is a mature product; therefore the entity will not undertake any activities to support the drug, which is consistent with its customary business practices.

Case B—Licence is distinct

In this case, the manufacturing process used to produce the drug is not unique or specialised and several other entities can also manufacture the drug for the customer.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct, and it concludes that the criteria in paragraph 27 of IFRS 15 are met for each of the licence and the

Extract from IFRS 15 (cont'd)

manufacturing service. The entity concludes that the criterion in paragraph 27(a) of IFRS 15 is met because the customer can benefit from the licence together with readily available resources other than the entity's manufacturing service (because there are other entities that can provide the manufacturing service), and can benefit from the manufacturing service together with the licence transferred to the customer at the start of the contract.

The entity also concludes that its promises to grant the licence and to provide the manufacturing service are separately identifiable (ie the criterion in paragraph 27(b) of IFRS 15 is met). The entity concludes that the licence and the manufacturing service are not inputs to a combined item in this contract on the basis of the principle and the factors in paragraph 29 of IFRS 15. In reaching this conclusion, the entity considers that the customer could separately purchase the licence without significantly affecting its ability to benefit from the licence. Neither the licence, nor the manufacturing service, is significantly modified or customised by the other and the entity is not providing a significant service of integrating those items into a combined output. The entity further considers that the licence and the manufacturing service are not highly interdependent or highly interrelated because the entity would be able to fulfil its promise to transfer the licence independently of fulfilling its promise to subsequently manufacture the drug for the customer. Similarly, the entity would be able to manufacture the drug for the customer even if the customer had previously obtained the licence and initially utilised a different manufacturer. Thus, although the manufacturing service necessarily depends on the licence in this contract (ie the entity would not provide the manufacturing service without the customer having obtained the licence), the licence and the manufacturing service do not significantly affect each other. Consequently, the entity concludes that its promises to grant the licence and to provide the manufacturing service are distinct and that there are two performance obligations:

(a) licence of patent rights; and

(b) manufacturing service.

The entity assesses, in accordance with paragraph B58 of IFRS 15, the nature of the entity's promise to grant the licence. The drug is a mature product (ie it has been approved, is currently being manufactured and has been sold commercially for the last several years). For these types of mature products, the entity's customary business practices are not to undertake any activities to support the drug. The drug compound has significant stand-alone functionality (ie its ability to produce a drug that treats a disease or condition). Consequently, the customer obtains a substantial portion of the benefits of the drug compound from that functionality, rather than from the entity's ongoing activities. The entity concludes that the criteria in paragraph B58 of IFRS 15 are not met because the contract does not require, and the customer does not reasonably expect, the entity to undertake activities that significantly affect the intellectual property to which the customer has rights. In its assessment of the criteria in paragraph B58 of IFRS 15, the entity does not take into consideration the separate performance obligation of promising to provide

Extract from IFRS 15 (cont'd)

a manufacturing service. Consequently, the nature of the entity's promise in transferring the licence is to provide a right to use the entity's intellectual property in the form and the functionality with which it exists at the point in time that it is granted to the customer. Consequently, the entity accounts for the licence as a performance obligation satisfied at a point in time.

The entity applies paragraphs 31–38 of IFRS 15 to determine whether the manufacturing service is a performance obligation satisfied at a point in time or over time.

8.1.2 Licences of intellectual property that are not distinct

The licences of intellectual property included in the examples above were determined to be distinct, as they met the two criteria of IFRS 15.27. In other situations, a licence of intellectual property may not be distinct from other promised goods or services in a contract, either because it is not capable of being distinct and/or it is not separately identifiable.

IFRS 15.B54 requires that a licence that is not distinct from other promised goods or services in a contract be combined into a single performance obligation. It also identifies two examples of licences of intellectual property that are not distinct from other goods or services, as follows:

- A licence that is a component of, and integral to the functionality of, a tangible good
- A licence that the customer can benefit from, but only in conjunction with a related service (e.g., as a result of the entity granting a licence, the customer has access to an online service provided by the entity)

In both examples, a customer only benefits from the combined output of the licence of intellectual property and the related good or service. Therefore, the licence is not distinct and would be combined with those other promised goods or services in the contract.

The standard includes other examples of licences of intellectual property that are not distinct, which are combined with other promised goods or services because the customer can only benefit from the licence in conjunction with a related service (as described in IFRS 15.B54(b)). For example, Example 55 and Example 56, Case A (extracted in full in section 8.2.1) illustrate contracts that include licences of intellectual property that are not distinct from other goods or services promised to the customer.

When an entity is required to bundle a licence of intellectual property with other promised goods or services in a contract, it often needs to consider the licensing application guidance to help determine the nature of its promise to the customer when the licence is the predominant item in the combined performance obligation. See section 8.2.4 for further discussion on applying the licensing application guidance to such performance obligations.

8.1.3 Contractual restrictions

Some licences contain substantive contractual restrictions on how the customer may employ a licence. The standard explicitly states that restrictions of time, geography or use do not affect the licensor's determination of whether the promise to transfer a licence is satisfied over time or at a point in time, as follows:

Extract from IFRS 15

B62. An entity shall disregard the following factors when determining whether a licence provides a right to access the entity's intellectual property or a right to use the entity's intellectual property:

(a) Restrictions of time, geographical region or use—those restrictions define the attributes of the promised licence, rather than define whether the entity satisfies its performance obligation at a point in time or over time.

While stakeholders acknowledged that IFRS 15.B62 is clear that restrictions of time, geographical region or use do not affect the licensor's determination about whether the promise to transfer a licence is satisfied over time or at a point in time, some stakeholders thought that the standard was unclear about whether particular types of contractual restrictions would affect the identification of the promised goods or services in the contract. For example, an arrangement might grant a customer a licence to a well-known television programme or movie for a period of time (for example, three years), but the customer might be restricted in how often it can show that licensed content to only once per year during each of those three years. In this instance, stakeholders thought that it may be unclear whether contractual restrictions affect the entity's identification of its promises in the contract (i.e., do the airing restrictions affect whether the entity has granted one licence or three licences?).[333]

In considering this issue further, the IASB explained that contracts that include a promise to grant a licence to a customer require an assessment of the promises in the contract using the criteria for identifying performance obligations, as is the case with other contracts.[334] This assessment is done before applying the criteria to determine the nature of an entity's promise in granting a licence.[335]

In the Basis for Conclusions, the IASB further explained that they considered Example 59 in the standard (see extract in section 8.3.2) in the context of this issue. The entity concludes that its only performance obligation is to grant the customer a right to use the music recording. When, where and how the right can be used is defined by the attributes of time (i.e., two years), geographical scope (i.e., Country A) and permitted use (i.e., in commercials). If, instead, the entity had granted the customer rights to use the recording for two different time periods in two geographical locations, for example, years X1–X3 in Country A and years X2–X4 in Country B, the entity would need to use the criteria for identifying performance obligations in IFRS 15.27–30 to determine whether the contract included one licence that covers both countries or separate licences for each country.[336]

[333] IFRS 15.BC414O.
[334] IFRS 15.BC405–BC406.
[335] IFRS 15.414P.
[336] IFRS 15.BC414Q.

Consequently, the entity considers all of the contractual terms to determine whether the promised rights result in the transfer to the customer of one or more licences. In making this determination, judgement is needed to distinguish between contractual provisions that create promises to transfer rights to use the entity's intellectual property from contractual provisions that establish when, where and how those rights may be used. Therefore, in the Board's view, the clarifications made to the requirements on identifying performance obligations in IFRS 15.22–30 provide sufficient guidance to entities.[337]

How we see it

We believe a critical part of the evaluation of contractual restrictions is whether the lifting of a restriction at a future date requires an entity to *grant additional rights* to the customer at that future date in order to fulfil its promises under the contract. The presence of a requirement to grant additional rights to the customer indicates that there may be multiple performance obligations that need to be accounted for under Step 2 of the model.

Entities may need to use significant judgement to distinguish between a single promised licence with multiple attributes and a licence that contains multiple promises to the customer that may be separate performance obligations.

FASB differences

ASC 606 requires that entities distinguish between contractual provisions that define the attributes of a single promised licence (e.g., restrictions of time, geography or use) and contractual provisions that require them to transfer additional goods or services to customers (e.g., additional rights to use or access intellectual property). Contractual provisions that are attributes of a promised licence define the scope of a customer's rights to intellectual property and do not affect whether a performance obligation is satisfied at a point in time or over time. Nor do they affect the number of performance obligations in the contract.

The IASB decided not to clarify the requirements for identifying performance obligations in a contract containing one or more licences since it had clarified the general requirements for identifying performance obligations.[338]

As a result, ASC 606 includes guidance on contractual restrictions that differs from the requirements in IFRS 15. However, the IASB noted in the Basis for Conclusions that, consistent with the ASC 606, an entity needs to apply the requirements in Step 2 of the general model on identifying performance obligations when distinguishing between contractual provisions that create promises to transfer additional rights from those that are merely attributes of a licence that establish when, where and how the right may be used.[339] Under both IFRS 15 and ASC 606, an entity may need to apply significant judgement to distinguish between a single promised licence with multiple attributes and a licence that contains multiple promises to the customer that may be separate performance obligations.

[337] IFRS 15.BC414P.
[338] IFRS 15.BC414P.
[339] IFRS 15.BC414P.

8.1.4 Guarantees to defend or maintain a patent (updated October 2020)

IFRS 15 states that a guarantee to defend or maintain a patent does not represent a performance obligation in a licensing contract. Furthermore, this type of guarantee does not affect the licensor's determination as to whether the licence provides a right to access intellectual property (satisfied over time) or a right to use intellectual property (satisfied at a point in time).

The requirements for guarantees to defend or maintain a patent are included in the following extract from the standard:

Extract from IFRS 15

B62. An entity shall disregard the following factors when determining whether a licence provides a right to access the entity's intellectual property or a right to use the entity's intellectual property:

(a) ...

(b) Guarantees provided by the entity that it has a valid patent to intellectual property and that it will defend that patent from unauthorised use — a promise to defend a patent right is not a performance obligation because the act of defending a patent protects the value of the entity's intellectual property assets and provides assurance to the customer that the licence transferred meets the specifications of the licence promised in the contract.

It is not unusual for intellectual property arrangements to include a clause that requires a licensor to defend and maintain related patents. While patent defence and maintenance is a continuing obligation, it is an obligation to ensure the licensee can continue to use the intellectual property as intended, and, as discussed above, is not a promised good or service under IFRS 15 that should be evaluated under Step 2. However, if there are questions regarding the validity of a patent at the time a licence arrangement is entered into, licensors need to consider whether that component of the arrangement meets the attributes to be considered a contract within the scope of the model (see section 3.1).

Furthermore, as discussed above, because such a provision is to ensure that the licensee can continue to use the intellectual property as intended, it is similar to an assurance-type warranty discussed in section 9.1 (i.e., a warranty that promises the customer that the delivered product is as specified in the contract). Assurance-type warranties are not within the scope of IFRS 15 and, as stated in IFRS 15.B30, would be accounted for in accordance with the requirements for product warranties in IAS 37.

Frequently asked questions

Question 8-1: How should entities account for modifications to licences of intellectual property?

A licence provides a customer with a right to use or a right to access the intellectual property of an entity. The terms of each licence of intellectual property are defined by the contract, which establishes the customer's rights (e.g., period of time, area of use). We believe that when a contract that only includes a licence of intellectual property is modified, the additional and/or modified licence of intellectual property is distinct from the original licence because the new and/or modified rights will always differ from those conveyed by the original licence.

Frequently asked questions (cont'd)

The standard contains requirements on accounting for contract modification (see section 3.4) and it requires that a modification in which the additional promised goods or services are distinct be accounted for on a prospective basis, as follows:

- The modification is accounted for as a separate contract if the additional consideration from the modification reflects the new licence's stand-alone selling price in accordance with IFRS 15.20(b).
- If the additional consideration does not reflect the stand-alone selling price of the new licence, the modification is accounted for in accordance with IFRS 15.21(a).

For a modification accounted for as a termination of the original contract and creation of a new contract in accordance with IFRS 15.21(a), any revenue recognised to date under the original contract is not adjusted. At the date of the modification, the remaining unrecognised transaction price from the original contract (if any) and the additional transaction price from the new contract are allocated to the remaining performance obligation(s) in the new contract. Any revenue allocated to a performance obligation created at the modification date for the renewal or extension of a licence would be recognised when (or as) that performance obligation is satisfied, which may not be until the beginning of the renewal or extension period (see section 8.4).

Question 8-2: Contracts that grant both permission for past use of intellectual property and a licence to use the intellectual property in the future

An entity may enter into a contract with a customer that grants the right to use intellctual property and the customer also agrees to pay consideration for past use of that intellectual property. Such an agreement may be partially a settlement for the use of the intellectual property in the past without the entity's permission.

In such circumstances, it may require judgement to determine what aspects of the contract are within the scope of IFRS 15.

If the contract is only partially within the scope of IFRS 15, an entity may need to use judgement when applying the requirements in IFRS 15.7 (see section 2.5) to separate the consideration between the revenue in exchange for the licence, any amount received for the past use and any other components.

8.2 Determining the nature of the entity's promise in granting a licence

Entities need to evaluate the nature of a promise to grant a licence of intellectual property in order to determine whether the promise is satisfied (and revenue is recognised) over time or at a point in time.

In order to help entities in determining whether a licence provides a customer with a right to access or a right to use the intellectual property (which is important when determining the period of performance and, therefore, the timing of revenue recognition – see section 8.3), the Board provided the following application guidance:

Extract from IFRS 15

B58. The nature of an entity's promise in granting a licence is a promise to provide a right to access the entity's intellectual property if all of the following criteria are met:

(a) the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights (see paragraphs B59 and B59A);

(b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities identified in paragraph B58(a); and

(c) those activities do not result in the transfer of a good or a service to the customer as those activities occur (see paragraph 25).

B59. Factors that may indicate that a customer could reasonably expect that an entity will undertake activities that significantly affect the intellectual property include the entity's customary business practices, published policies or specific statements. Although not determinative, the existence of a shared economic interest (for example, a sales-based royalty) between the entity and the customer related to the intellectual property to which the customer has rights may also indicate that the customer could reasonably expect that the entity will undertake such activities.

B59A. An entity's activities significantly affect the intellectual property to which the customer has rights when either:

(a) those activities are expected to significantly change the form (for example, the design or content) or the functionality (for example, the ability to perform a function or task) of the intellectual property; or

(b) the ability of the customer to obtain benefit from the intellectual property is substantially derived from, or dependent upon, those activities. For example, the benefit from a brand is often derived from, or dependent upon, the entity's ongoing activities that support or maintain the value of the intellectual property.

Accordingly, if the intellectual property to which the customer has rights has significant stand-alone functionality, a substantial portion of the benefit of that intellectual property is derived from that functionality. Consequently, the ability of the customer to obtain benefit from that intellectual property would not be significantly affected by the entity's activities unless those activities significantly change its form or functionality. Types of intellectual property that often have significant stand-alone functionality include software, biological compounds or drug formulas, and completed media content (for example, films, television shows and music recordings).

In providing this application guidance, the Board decided to focus on the characteristics of a licence that provides a right to access the entity's intellectual property. If the licensed intellectual property does not have those characteristics, it provides a right to use the entity's intellectual property, by default. This analysis is focused on situations in which the underlying intellectual property is subject to change over the licence period.

The key determinants of whether the nature of an entity's promise is a right to access the entity's intellectual property are whether: (1) the entity is required to undertake activities that affect the licensed intellectual property (or the customer has a reasonable expectation that the entity will do so); and (2) the customer is exposed to positive or negative effects resulting from those changes.

It is important to note that when an entity is making this assessment, it excludes the effect of any other performance obligations in the contract. For example, if an entity enters into a contract to license software and provide access to any future upgrades to that software during the licence period, the entity first determines whether the licence and the promise to provide future updates are separate performance obligations. If they are separate, when the entity considers whether it has a contractual (explicit or implicit) obligation to undertake activities to change the software during the licence period, it excludes any changes and activities associated with the performance obligation to provide future upgrades.

While the activities considered in this assessment do not include those that are a performance obligation, these activities can be part of an entity's ongoing ordinary activities and customary business practices (i.e., they do not have to be activities the entity is undertaking specifically as a result of the contract with the customer). In addition, the IASB noted in the Basis for Conclusions that the existence of a shared economic interest between the parties (e.g., sales-based or usage-based royalties) may be an indicator that the customer has a reasonable expectation that the entity will undertake such activities.[340]

After an entity has identified the activities for this assessment, it must determine if those activities significantly affect the intellectual property to which the customer has rights. The standard clarifies that such activities significantly affect the intellectual property if they:

- Significantly change the form (e.g., design or content) or functionality (e.g., the ability to perform a function or task) of the intellectual property

  Or

- Affect the ability of the customer to obtain benefit from the intellectual property (e.g., the benefit from a brand is often derived from, or dependent upon, the entity's ongoing activities that support or maintain the value of the intellectual property)

If the intellectual property has significant stand-alone functionality, the standard clarifies that the customer derives a substantial portion of the benefit of that intellectual property from that functionality. As such, "the ability of the customer to obtain benefit from that intellectual property would not be significantly affected by the entity's activities unless those activities significantly change its form or functionality."[341] Therefore, if the intellectual property has significant stand-alone functionality, revenue is recognised at a point in time. Examples of types of intellectual property that may have significant stand-alone functionality that are mentioned in the standard include

[340] IFRS 15.BC413.
[341] IFRS 15.B59A.

software, biological compounds or drug formulas, and completed media content.

The IASB has not defined the term 'significant stand-alone functionality', but has made clarifications to the examples in the standard to illustrate when the intellectual property to which the customer has rights may have significant stand-alone functionality. In some cases, it will be clear when intellectual property has significant stand-alone functionality. If there is no significant stand-alone functionality, the benefit to the customer might be substantially derived from the value of the intellectual property and the entity's activities to support or maintain that value. The IASB noted, however, that an entity may need to apply judgement to determine whether the intellectual property to which the customer has rights has significant stand-alone functionality.[342]

How we see it

It is important for entities that provide licences of intellectual property to their customers to appropriately identify the performance obligations as part of Step 2 of the model because those conclusions may directly affect their evaluation of whether the entity's activities significantly change the form or functionality of the intellectual property or affect the ability of the customer to obtain benefit from the intellectual property.

FASB differences

Unlike IFRS 15, ASC 606 requires entities to classify intellectual property in one of two categories to determine the nature of the entity's promise in granting a licence:

(a) *Functional*: This intellectual property has significant stand-alone functionality (e.g., many types of software, completed media content such as films, television shows and music). Revenue for these licences is recognised at the point in time when the intellectual property is made available for the customer's use and benefit if the functionality is not expected to change substantively as a result of the licensor's ongoing activities that do not transfer another good or service to the customer. If the functionality of the intellectual property is expected to substantively change because of the activities of the licensor that do not transfer promised goods or services and the customer is contractually or practically required to use the latest version of the intellectual property, revenue for the licence is recognised over time. The FASB noted in its Basis for Conclusions on ASU 2016-10 that it expects entities to meet the criteria to recognise licences of functional intellectual property over time infrequently, if at all.

(b) *Symbolic*: This intellectual property does not have significant stand-alone functionality (e.g., brands, team and trade names, character images). The utility of symbolic intellectual property is derived from the licensor's ongoing or past activities (e.g., activities that support the value of character images licensed from an animated film). Revenue from these licences is recognised over time as the performance obligation is satisfied (e.g., over the licence period).

[342] IFRS 15.BC414I.

The IASB and FASB agreed that their approaches will generally result in consistent answers, but the Boards acknowledged that different outcomes may arise due to the different approaches when entities license brand names that no longer have any related ongoing activities (e.g., the licence to the brand name of a defunct sports team, such as the Brooklyn Dodgers). Under the FASB's approach, a licence of a brand name would be classified as symbolic intellectual property and revenue would be recognised over time, regardless of whether there are any related ongoing activities. Under the IASB's approach, revenue is recognised at a point in time if there are no ongoing activities that significantly affect the intellectual property.[343]

8.2.1 Applying the licensing application guidance to a single (bundled) performance obligation that includes a licence of intellectual property

IFRS 15 does not explicitly state that an entity needs to consider the nature of its promise in granting a licence when applying the general revenue recognition model to performance obligations that are comprised of both a licence (that is not distinct) and other goods or services. However, the Board clarified in the Basis for Conclusions that to the extent that an entity is required to combine a licence with other promised goods or services in a single performance obligation and the licence is the primary or dominant component (i.e., the predominant item) of that performance obligation, the entity needs to consider the licensing application guidance to help determine the nature of its promise to the customer.[344]

If the licence is a predominant item of a single performance obligation, entities need to consider the licensing application guidance when:

(a) Determining whether the performance obligation is satisfied over time or at a point in time

And

(b) Selecting an appropriate method for measuring progress of that performance obligation if it is satisfied over time

Considering the nature of an entity's promise in granting a licence that is part of a single combined performance obligation is not a separate step or evaluation in the revenue model. Rather, it is part of the overall requirements in Step 5 of the model to determine whether that single performance obligation is satisfied over time or at a point in time and the appropriate measure of progress toward the satisfaction, if it is satisfied over time.

The Board did not provide application guidance or bright lines for determining when a licence is the primary or dominant (i.e., the predominant) component. However, the IASB explained in the Basis for Conclusions that, in some instances, not considering the nature of the entity's promise in granting a licence that is combined with other promised goods or services in a single performance obligation would result in accounting that does not best reflect the entity's performance. For example, consider a situation where an entity grants a 10-year licence that is not distinct from a one-year service arrangement. The IASB noted that a distinct licence that provides access to an entity's intellectual property over a 10-year period could not be considered completely satisfied before the end of the access period. The IASB observed in that example that it is, therefore, inappropriate to conclude that a single

[343] IFRS 15.BC414K, BC414N.
[344] IFRS 15.BC407.

performance obligation that includes that licence is satisfied over the one-year period of the service arrangement.[345]

The standard includes examples that illustrate how an entity applies the licensing application guidance to help determine the nature of a performance obligation that includes a licence of intellectual property and other promised goods or services.

In Example 56, Case A (extracted below), an entity licences the patent rights for an approved drug compound to its customer and also promises to manufacture the drug for the customer. The entity considers that no other entity can perform the manufacturing service because of the highly specialised nature of the manufacturing process. Therefore, the licence cannot be purchased separately from the manufacturing service and the customer cannot benefit from the licence on its own or with other readily available resources (i.e., the licence and the manufacturing service are not capable of being distinct). Accordingly, the entity's promises to grant the licence and to manufacture the drug are accounted for as a single performance obligation, as follows:

Extract from IFRS 15

Example 56 — Identifying a distinct licence (IFRS 15.IE281-IE284)

An entity, a pharmaceutical company, licenses to a customer its patent rights to an approved drug compound for 10 years and also promises to manufacture the drug for the customer. The drug is a mature product; therefore the entity will not undertake any activities to support the drug, which is consistent with its customary business practices.

Case A—Licence is not distinct

In this case, no other entity can manufacture this drug because of the highly specialised nature of the manufacturing process. As a result, the licence cannot be purchased separately from the manufacturing services.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of IFRS 15. The entity determines that the customer cannot benefit from the licence without the manufacturing service; therefore, the criterion in paragraph 27(a) of IFRS 15 is not met. Consequently, the licence and the manufacturing service are not distinct and the entity accounts for the licence and the manufacturing service as a single performance obligation.

The entity applies paragraphs 31–38 of IFRS 15 to determine whether the performance obligation (ie the bundle of the licence and the manufacturing services) is a performance obligation satisfied at a point in time or over time.

The example in the extract above (Example 56, Case A) illustrates the importance of applying the licensing application guidance when determining the nature of an entity's promise in granting a licence that is combined into a single performance obligation with other promised goods or services. This is because the conclusion of whether a non-distinct licence provides the customer with a right to use intellectual property or a right to access intellectual property may have a significant effect on the timing of revenue recognition for the single combined performance obligation. In Example 56, Case A, the entity needs to determine the nature of its promise in granting the licence within the single performance obligation (comprising the licence and the manufacturing service) to appropriately apply the general principle of recognising revenue when (or as)

[345] IFRS 15.BC414X.

it satisfies its performance obligation to the customer. If the licence in this example provided a right to use the entity's intellectual property that on its own would be recognised at the point in time in which control of the licence is transferred to the customer, it is likely that the combined performance obligation would only be fully satisfied when the manufacturing service is complete. In contrast, if the licence provided a right to access the entity's intellectual property, the combined performance obligation would not be fully satisfied until the end of the 10-year licence period, which could extend the period of revenue recognition beyond the date when the manufacturing service is complete.

FASB differences

ASC 606 explicitly states that an entity considers the nature of its promise in granting a licence when applying the general revenue recognition model to a single performance obligation that includes a licence and other goods or services (i.e., when applying the general requirements, consistent with those in IFRS 15.31–45, to assess whether the performance obligations are satisfied at a point in time or over time). Consequently, when the licence is not the predominant item in a single performance obligation, this may result in a US GAAP preparer considering the nature of its promise in granting a licence in a greater number of circumstances than an IFRS preparer.[346] The determination of whether a licence is the predominant component may be obvious in some cases, but not in others. Therefore, entities may need to exercise significant judgement and consider both qualitative and quantitative factors.

8.3 Transfer of control of licensed intellectual property

When determining whether a licence of intellectual property transfers to a customer (and revenue is recognised) over time or at a point in time, the standard states that an entity provides a customer with either:

- A right to access the entity's intellectual property throughout the licence period for which revenue is recognised over the licence period

  Or

- A right to use the entity's intellectual property as it exists at the point in time the licence is granted for which revenue is recognised at the point in time the customer can first use and benefit from the licensed intellectual property

[346] IFRS 15.BC414Y.

The standard provides the following application guidance on the timing of revenue recognition for right-to-access and right-to-use licences:

Extract from IFRS 15

B60. If the criteria in paragraph B58 are met, an entity shall account for the promise to grant a licence as a performance obligation satisfied over time because the customer will simultaneously receive and consume the benefit from the entity's performance of providing access to its intellectual property as the performance occurs (see paragraph 35(a)). An entity shall apply paragraphs 39–45 to select an appropriate method to measure its progress towards complete satisfaction of that performance obligation to provide access.

B61. If the criteria in paragraph B58 are not met, the nature of an entity's promise is to provide a right to use the entity's intellectual property as that intellectual property exists (in terms of form and functionality) at the point in time at which the licence is granted to the customer. This means that the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licence at the point in time at which the licence transfers. An entity shall account for the promise to provide a right to use the entity's intellectual property as a performance obligation satisfied at a point in time. An entity shall apply paragraph 38 to determine the point in time at which the licence transfers to the customer. However, revenue cannot be recognised for a licence that provides a right to use the entity's intellectual property before the beginning of the period during which the customer is able to use and benefit from the licence. For example, if a software licence period begins before an entity provides (or otherwise makes available) to the customer a code that enables the customer to immediately use the software, the entity would not recognise revenue before that code has been provided (or otherwise made available).

8.3.1 Right to access (updated October 2020)

The Board concluded that a licence that provides an entity with the right to access intellectual property is satisfied over time "because the customer simultaneously receives and consumes the benefit from the entity's performance as the performance occurs", including the related activities undertaken by entity.[347] This conclusion is based on the determination that when a licence is subject to change (and the customer is exposed to the positive or negative effects of that change), the customer is not able to fully gain control over the licence of intellectual property at any given point in time, but rather gains control over the licence period. Entities need to apply the general Step 5 requirements in IFRS 15.39-45 to determine the appropriate method to measure progress (see section 7.1.4) in addition to IFRS 15.B61 (i.e., the use and benefit requirement, which is discussed below in section 8.3.3). In performing this analysis, an entity should not default to a straight-line revenue attribution model. However, the customer may often receive and consume the benefits of a right-to-access licence evenly over the contract period and, therefore, a time-based measure of progress that results in a straight-line recognition of revenue would be appropriate.

[347] IFRS 15.BC414.

The standard includes the following example of a right-to-access licence:

Extract from IFRS 15

Example 58 — Access to intellectual property (IFRS 15.IE297-IE302)

An entity, a creator of comic strips, licenses the use of the images and names of its comic strip characters in three of its comic strips to a customer for a four-year term. There are main characters involved in each of the comic strips. However, newly created characters appear regularly and the images of the characters evolve over time. The customer, an operator of cruise ships, can use the entity's characters in various ways, such as in shows or parades, within reasonable guidelines. The contract requires the customer to use the latest images of the characters.

In exchange for granting the licence, the entity receives a fixed payment of CU1 million in each year of the four-year term.

In accordance with paragraph 27 of IFRS 15, the entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity concludes that it has no other performance obligations other than the promise to grant a licence. That is, the additional activities associated with the licence do not directly transfer a good or service to the customer because they are part of the entity's promise to grant a licence.

The entity assesses the nature of the entity's promise to transfer the licence in accordance with paragraph B58 of IFRS 15. In assessing the criteria the entity considers the following:

(a) the customer reasonably expects (arising from the entity's customary business practices) that the entity will undertake activities that will significantly affect the intellectual property to which the customer has rights (ie the characters). This is because the entity's activities (ie development of the characters) change the form of the intellectual property to which the customer has rights. In addition, the ability of the customer to obtain benefit from the intellectual property to which the customer has rights is substantially derived from, or dependent upon, the entity's ongoing activities (ie the publishing of the comic strip).

(b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities because the contract requires the customer to use the latest characters.

(c) even though the customer may benefit from those activities through the rights granted by the licence, they do not transfer a good or service to the customer as those activities occur.

Consequently, the entity concludes that the criteria in paragraph B58 of IFRS 15 are met and that the nature of the entity's promise to transfer the licence is to provide the customer with access to the entity's intellectual property as it exists throughout the licence period. Consequently, the entity accounts for the promised licence as a performance obligation satisfied over time (ie the criterion in paragraph 35(a) of IFRS 15 is met).

The entity applies paragraphs 39–45 of IFRS 15 to identify the method that best depicts its performance in the licence. Because the contract provides the customer with unlimited use of the licensed characters for a fixed term, the entity determines that a time-based method would be the most appropriate measure of progress towards complete satisfaction of the performance obligation.

Frequently asked questions

Question 8-3: Is a licence that provides a right to access intellectual property a series of distinct goods or services that would be accounted for as a single performance obligation?

Step 2 of the model requires an entity to identify the performance obligations in a contract. This includes determining whether multiple distinct goods or services would be accounted for as a single performance obligation under the series requirement (see section 4.2.2). It is likely that many licences that provide a right to access intellectual property may be a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer (e.g., a series of distinct periods of access to intellectual property, such as monthly access or quarterly access).

A TRG agenda paper included an example of a licence that provides a right to access intellectual property that is accounted for as a series of distinct goods or services.[348] In the example, a franchisor grants a licence of intellectual property to a franchisee allowing the franchisee to use its trade name and sell its product for a period of 10 years. As discussed in Question 4-9 in section 4.2.2, if the nature of an entity's promise is to provide a single service for a period of time, the evaluation of whether goods or services are distinct and substantially the same considers whether each time increment of access to the intellectual property (e.g., hour, day) is distinct and substantially the same. In this example, the nature of the franchisor's promise is to provide a right to access the intellectual property throughout the licence period. Each time increment is distinct because the customer benefits from the right to access each day on its own (i.e., each time increment is capable of being distinct). In addition, each day is separately identifiable (i.e., each time increment is distinct in the context of the contract) because: there is no integration service provided between the days of access provided; no day modifies or customises another; and the days of access are not highly interdependent or highly interrelated. In addition, each distinct daily service is substantially the same because the customer receives access to the intellectual property each day.

If a licence meets the criteria to be accounted for as a series of distinct goods or services, an entity needs to consider whether any variable consideration in the contract (e.g., royalties, milestone payments) should be allocated to the distinct periods of access, if certain allocation criteria are met. See section 6.3 for a discussion of the variable consideration allocation exception and section 8.5 for a discussion of the accounting for sales-based or usage-based royalties.

8.3.2 Right to use

In contrast, when the licence represents a right to use the intellectual property as it exists at a specific point in time, the customer gains control over that intellectual property at the beginning of the period for which it has the right to use the intellectual property. This timing may differ from when the licence was granted. For example, an entity may provide a customer with the right to use intellectual property, but indicate that right to use does not start until 30 days after the agreement is finalised. For the purpose of determining when control transfers for the right-to-use licence, the Board was clear that the assessment is from the customer's perspective (i.e., when the customer can use the licensed intellectual property), rather than the entity's perspective (i.e., when the entity

[348] TRG Agenda paper no. 39, *Application of the Series Provision and Allocation of Variable Consideration*, dated 13 July 2015.

transfers the licence). Entities need to apply the general Step 5 requirements in IFRS 15.38 to determine the point in time that control of the licence transfers to the customer (see section 7.2) in addition to IFRS 15.B61 (i.e., the use and benefit requirement, which is discussed below in section 8.3.3).

The standard includes the following example of a right-to-use licence:

Extract from IFRS 15

Example 59 — Right to use intellectual property (IFRS 15.IE303-IE306)

An entity, a music record label, licenses to a customer a 1975 recording of a classical symphony by a noted orchestra. The customer, a consumer products company, has the right to use the recorded symphony in all commercials, including television, radio and online advertisements for two years in Country A. In exchange for providing the licence, the entity receives fixed consideration of CU10,000 per month. The contract does not include any other goods or services to be provided by the entity. The contract is non-cancellable.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of IFRS 15. The entity concludes that its only performance obligation is to grant the licence. The entity determines that the term of the licence (two years), its geographical scope (the customer's right to use the recording only in Country A), and the defined permitted use for the recording (in commercials) are all attributes of the promised licence in the contract.

In accordance with paragraph B58 of IFRS 15, the entity assesses the nature of the entity's promise to grant the licence. The entity does not have any contractual or implied obligations to change the licensed recording. The licensed recording has significant stand-alone functionality (ie the ability to be played) and, therefore, the ability of the customer to obtain the benefits of the recording is not substantially derived from the entity's ongoing activities. The entity therefore determines that the contract does not require, and the customer does not reasonably expect, the entity to undertake activities that significantly affect the licensed recording (ie the criterion in paragraph B58(a) is not met). Consequently, the entity concludes that the nature of its promise in transferring the licence is to provide the customer with a right to use the entity's intellectual property as it exists at the point in time that it is granted. Therefore, the promise to grant the licence is a performance obligation satisfied at a point in time. The entity recognises all of the revenue at the point in time when the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licensed intellectual property.

Because of the length of time between the entity's performance (at the beginning of the period) and the customer's monthly payments over two years (which are non-cancellable), the entity considers the requirements in paragraphs 60–65 of IFRS 15 to determine whether a significant financing component exists.

8.3.3 Use and benefit requirement

IFRS 15 states that revenue from a right-to-use licence cannot be recognised before the beginning of the period during which "the customer is able to use and benefit from the licence".[349] The IASB explained in the Basis for Conclusions that if the customer cannot use and benefit from the licensed intellectual property then, by definition, it does not control the licence.[350] See section 8.4 for discussion on licence renewals.

Consider an example where an entity provides a customer with a right to use its software, but the customer requires a code before the software will function, which the entity will not provide until 30 days after the agreement is finalised. In this example, it is likely that the entity would conclude that control of the licence does not transfer until 30 days after the agreement is finalised because that is when the customer has the right to use and can benefit from the software.

8.4 Licence renewals

As discussed in section 8.3.3 above, IFRS 15 states that revenue cannot be recognised for a licence that provides a right to use the entity's intellectual property before the beginning of the period during which the customer is able to use and benefit from the licence.[351] Some stakeholders questioned whether IFRS 15.B61 applies to the renewal of an existing licence or whether the entity could recognise revenue for the renewal when the parties agree to the renewal. Therefore, TRG discussed the application of IFRS 15.B61 within the context of renewals or extensions of existing licences.[352] The discussion at the TRG indicated that this is an area in which judgement is needed and, therefore, this topic was further discussed by the IASB.[353]

The IASB decided that a clarification about the application of the contract modification requirements specifically for renewals of licensing arrangements was not necessary. The Board noted that, although some diversity may arise, IFRS 15 provides an extensive framework for applying judgement (see Question 8-1 for further discussion on modifications of licences).

Therefore, when an entity and a customer enter into a contract to renew (or extend the period of) an existing licence, the entity needs to evaluate whether the renewal or extension should be treated as a new licence or as a modification of the existing contract. A modification would be accounted for in accordance with the contract modifications requirements in IFRS 15.18–21 (see section 3.4).[354]

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[349] IFRS 15.B61.
[350] IFRS 15.BC414.
[351] IFRS 15.B61.
[352] IFRS 15.BC414S.
[353] TRG Agenda paper no. 45, *Licences – Specific Application Issues About Restrictions and Renewals*, dated 9 November 2015.
[354] IFRS 15.BC414T.

FASB differences

Under ASC 606, revenue related to the renewal of a licence of intellectual property may not be recognised earlier than the beginning of the renewal period. This is the case even if the entity provides a copy of the intellectual property in advance or the customer has a copy of the intellectual property from another transaction. The FASB also provided an additional example to illustrate this point.

IFRS 15 does not include similar requirements. Therefore, the IASB noted in the Basis for Conclusions that entities that report under IFRS might recognise revenue for contract renewals or extensions earlier than entities that report under US GAAP.[355]

In May 2019, the FASB added a project to the agenda of the Emerging Issues Task Force (EITF) on contract modifications of licences of intellectual property. The EITF's ongoing discussions are focused on two issues related to contract modifications for licences of intellectual property: (1) accounting for modifications that extend a licence term, but are not solely a renewal of the terms and conditions of the original licence; and (2) accounting for the revocation of a licence, including the conversion of a term software licence to a SaaS arrangement.

8.5 Sales-based or usage-based royalties on licences of intellectual property (updated October 2020)

The standard provides application guidance on the recognition of revenue for sales-based or usage-based royalties on licences of intellectual property, which differs from the requirements that apply to other revenue from licences. IFRS 15 requires that royalties received in exchange for licences of intellectual property are recognised at the later of when:

(a) The subsequent sale or usage occurs

And

(b) The performance obligation to which some or all of the sales-based or usage-based royalty has been allocated is satisfied (or partially satisfied)

That is, an entity recognises the royalties as revenue for such arrangements when (or as) the customer's subsequent sales or usage occurs, unless that pattern of recognition accelerates revenue recognition ahead of the entity's satisfaction of the performance obligation to which the royalty solely or partially relates, based on an appropriate measure of progress (see section 7.1.4).[356]

The Board explained in the Basis for Conclusions that for a licence of intellectual property for which the consideration is based on the *customer's* subsequent sales or usage, an entity does not recognise any revenue for the variable amounts until the uncertainty is resolved (i.e., when a customer's subsequent sales or usage occurs).[357]

[355] IFRS 15.BC414U.
[356] IFRS 15.BC421I.
[357] IFRS 15.BC219.

The IASB also explained in the Basis for Conclusions that the application guidance in IFRS 15.B63-B63B addresses the *recognition* of sales-based or usage-based royalties received in exchange for a licence of intellectual property, rather than when such amounts are included in the transaction price of the contract.[358] As a result, this exception is a recognition constraint and the constraint on variable consideration (see section 5.2.3) does not apply.

While the variable consideration constraint does not apply, the other requirements for variable consideration still apply (see section 5.2.2). However, as mentioned in Question 5-9 in section 5.2.2, this may be one of the situations where an entity may not need to estimate variable consideration at contract inception. This is because, in many cases, using this application guidance will result in the same pattern of revenue recognition as fully constraining the estimate of variable consideration associated with the future royalty stream (also see section 8.5.1 for more information about recognition of royalties for a licence that provides a right to access the entity's intellectual property). However, in cases where an entity is required to allocate sales-based or usage-based royalties to separate performance obligations in a contract, it may need to include expected royalties in its estimate of the stand-alone selling price of one or more of the performance obligations.The Board explained that it added the royalty recognition constraint because both users and preparers of financial statements indicated that it would not be useful for entities to recognise a minimum amount of revenue for sales-based or usage-based royalties received in exchange for licences of intellectual property (following the requirements in the general model on estimating the transaction price). This is because that approach would inevitably require the entity to report significant adjustments to the amount of revenue recognised throughout the life of the contract as a result of changes in circumstances that are not related to the entity's performance. The Board observed that this would not result in relevant information, especially for contracts in which the sales-based or usage-based royalties are paid over a long period of time.[359]

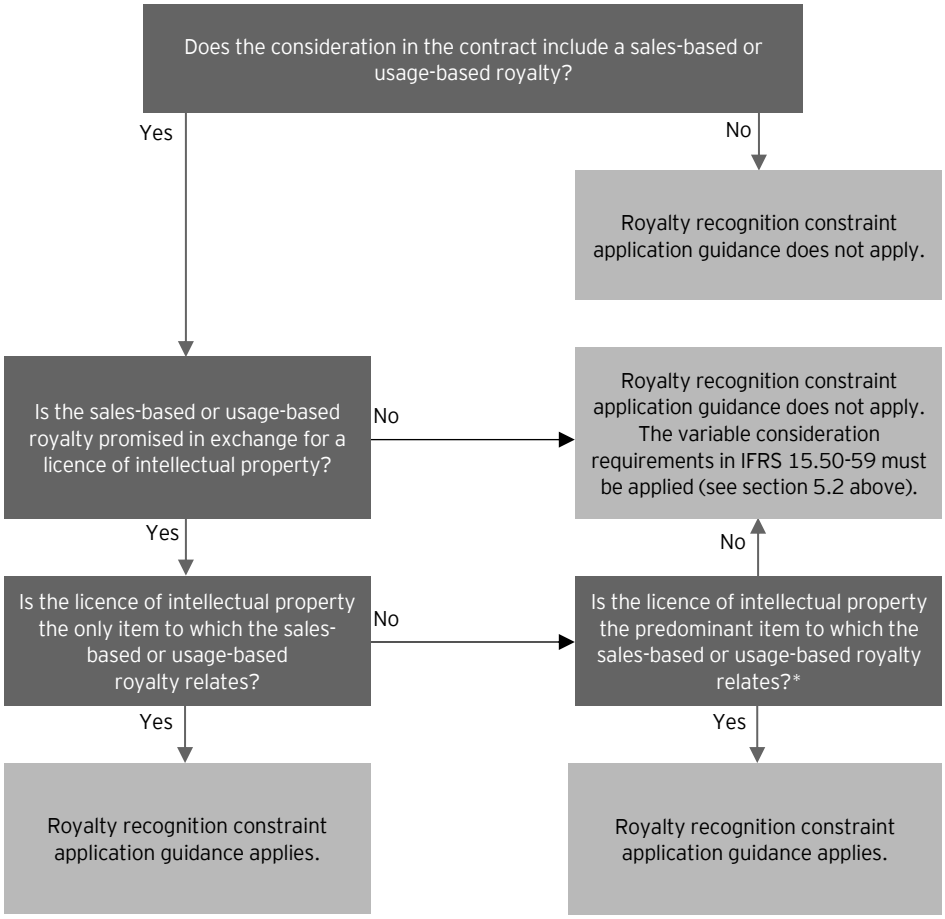
In some contracts, a sales-based or usage-based royalty may be related to both a licence of intellectual property and another good or service that may, or may not, be distinct. IFRS 15.B63A requires that the royalty recognition constraint be applied to the overall royalty stream when the sole or predominant item to which the royalty relates is a licence of intellectual property (including when no single licence of intellectual property is the predominant item to which the royalty relates, but the royalty predominantly relates to two or more licences of intellectual property in the contract).[360] That is, this application guidance is applicable to all licences of intellectual property, regardless of whether they have been determined to be distinct. The standard does not provide a bright line for determining the 'predominant' item in a contract that includes a licence of intellectual property. The Board acknowledged in the Basis for Conclusions that significant judgement may be required to determine when a licence is the predominant item to which a royalty relates. However, the judgement for determining whether a licence is the predominant item is likely to be less than the judgement needed to apply the general requirements for variable consideration to such contracts.[361]

It is important to note that the application guidance in IFRS 15.B63-B63B applies only to licences of intellectual property for which some or all of the consideration is in the form of a sales-based or usage-based royalty. The Board said in the

[358] IFRS 15.BC421I.
[359] IFRS 15.BC415.
[360] IFRS 15.BC421G.
[361] IFRS 15.BC421E.

Basis for Conclusions that the royalty recognition constraint was structured to apply only to a particular type of transaction (i.e., a licence of intellectual property). Therefore, other transactions that may be economically similar would be accounted for differently.[362] That is, entities cannot analogise to the royalty recognition constraint for other types of transactions. For example, it cannot be applied if consideration in a contract is in the form of a sales-based or usage-based royalty, but there is either: (a) no licence of intellectual property; or (b) the licence of intellectual property to which the sales-based or usage-based royalty relates is not the predominant item in the contract (e.g., the sale of a tangible good that includes a significant amount of intellectual property). When the royalty recognition constraint cannot be applied, an entity follows the requirements in the general model on estimating variable consideration and applying the constraint on variable consideration (see section 5.2). In some cases, it may not be obvious as to whether the arrangement is an in-substance sale of intellectual property (i.e., a promise that is in the form of a licence, but, in substance, has the characteristics of a sale) or a licence of intellectual property. In such instances, entities would have to exercise judgement to determine whether the control over the underlying intellectual property has been transferred from the entity to the customer and therefore, has been sold.

The following flow chart illustrates an entity's evaluation when determining whether the royalty recognition constraint should be applied to a royalty stream:



* This includes situations in which no single licence is the predominant item to which the sales-based or usage-based royalty relates, but the sales-based or usage-based royalty predominantly relates to two or more licences in the contract.

[362] IFRS 15.BC416.

The standard provides the following example of a contract that includes two performance obligations, including a licence that provides a right to use the entity's intellectual property and consideration in the form of sales-based royalties. In the example, the licence is determined to be the predominant item to which the royalty relates:

Extract from IFRS 15

Example 60 — Sales-based royalty for a licence of intellectual property (IFRS 15.IE307-IE308)

An entity, a movie distribution company, licenses Movie XYZ to a customer. The customer, an operator of cinemas, has the right to show the movie in its cinemas for six weeks. Additionally, the entity has agreed to (a) provide memorabilia from the filming to the customer for display at the customer's cinemas before the beginning of the six-week screening period; and (b) sponsor radio advertisements for Movie XYZ on popular radio stations in the customer's geographical area throughout the six-week screening period. In exchange for providing the licence and the additional promotional goods and services, the entity will receive a portion of the operator's ticket sales for Movie XYZ (ie variable consideration in the form of a sales-based royalty).

The entity concludes that the licence to show Movie XYZ is the predominant item to which the sales-based royalty relates because the entity has a reasonable expectation that the customer would ascribe significantly more value to the licence than to the related promotional goods or services.

The entity recognises revenue from the sales-based royalty, the only consideration to which the entity is entitled under the contract, wholly in accordance with paragraph B63. If the licence, the memorabilia and the advertising activities are separate performance obligations, the entity would allocate the sales-based royalty to each performance obligation.

As illustrated in the extract above (Example 60), IFRS 15.B63B states that, when the criteria for applying the royalty recognition constraint are applied, the royalty stream must be accounted for entirely under the royalty recognition constraint. That is, an entity would not split a single royalty and apply the royalty recognition constraint to a portion of the sales-based royalty and the general constraint requirements for variable consideration (see section 5.2.3) to the remainder. The Board indicated in the Basis for Conclusions that it would be more complex to account for part of a royalty under the royalty recognition constraint and another part under the general requirements for variable consideration and that doing so would not provide any additional useful information to users of financial statements. This is because splitting a royalty would result in an entity recognising an amount at contract inception that would reflect neither the amount to which the entity expects to be entitled, based on its performance, nor the amount to which the entity has become legally entitled during the period.[363]

Regardless of whether an entity applies the royalty recognition constraint or the general requirements for variable consideration, it is still required to allocate sales-based or usage-based royalties to separate performance obligations in a contract (as noted in Example 60 above). In order to perform such an allocation, an entity may need to include expected royalties in its estimate of the stand-alone selling price of one or more of the performance obligations. Example 35 from the standard (extracted in full in section 6.3) also illustrates the allocation of the transaction price (including sales-based or usage-based royalties) to the performance obligations in the contract.

[363] IFRS 15.BC421J.

8.5.1 Recognition of royalties for a licence that provides a right to access intellectual property (updated October 2020)

The IASB explained in the Basis for Conclusions that the royalty recognition constraint is intended to align the recognition of sales or usage-based royalties with the standard's key principle that revenue should be recognised when (or as) an entity satisfies a performance obligation. As discussed above, IFRS 15 requires that royalties received in exchange for licences of intellectual property are recognised at the later of when: (1) the subsequent sales or usage occurs; and (2) the performance obligation to which the sales-based or usage-based royalties relates has been satisfied (or partially satisfied). That is, an entity recognises the royalties as revenue when (or as) the customer's subsequent sales or usage occurs, unless that pattern of recognition accelerates revenue recognition ahead of the entity's satisfaction of the performance obligation to which the royalty solely or partially relates, based on an appropriate measure of progress (see section 7.1.4).[364]

Consider the following example, which was provided by the FASB, that illustrates when revenue recognition may be inappropriately accelerated ahead of an entity's performance, if revenue was recognised under IFRS 15.B63(a) for a right-to-access licence:[365]

Example of a licensing contract with a declining royalty rate

A contract provides a customer with the right to access an entity's intellectual property and the entity receives royalties of 8% on total sales up to CU1 million, 4% on the next CU3 million in sales and 2% on all sales above CU4 million. The declining royalty rate does not reflect changing value to the customer.

In this example, the FASB noted that recognising royalties as they are due (i.e., according to the contractual formula) would not be aligned with the principle of recognising revenue only when (or as) an entity satisfies a performance obligation because the right to access the intellectual property is provided evenly over the licence term while the declining royalty rate does not reflect the value to the customer. However, the FASB stated that the existence of a declining royalty rate in a contract does not always mean that recognising revenue for sales-based or usage-based royalties as the customer's underlying sales or usage occur is inappropriate. In fact, it would be appropriate if the declining royalty rate reflects the changing value to the customer.

The above example notwithstanding, for many contracts with licences that provide a right to access an entity's intellectual property, applying the royalty recognition constraint results in an entity recognising revenue from sales-based or usage-based royalties when (or as) the customer's underlying sales or usage occurs in accordance with IFRS 15.B63(a). An output-based measure of progress that is the same as, or similar to, the application of the practical expedient in IFRS 15.B16 (i.e., when the right to consideration corresponds directly with the value to the customer of the entity's performance to date) is appropriate because the entity's right to consideration (i.e., the sales-based or usage-based royalties earned) often corresponds directly with the value to the customer of the entity's performance completed to date. The practical expedient in IFRS 15.B16 is discussed further in section 7.1.4.

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[364] IFRS 15.BC421I.

[365] ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, April 2016, paragraph BC71.

In addition, an output-based measure could also be appropriate for a licence that provides a right to access intellectual property in which the consideration is in the form of a fixed fee and royalties. The following example from the standard illustrates this:

Extract from IFRS 15

Example 61 — Access to intellectual property (IFRS 15.IE309-IE313)

An entity, a well-known sports team, licenses the use of its name and logo to a customer. The customer, an apparel designer, has the right to use the sports team's name and logo on items including t-shirts, caps, mugs and towels for one year. In exchange for providing the licence, the entity will receive fixed consideration of CU2 million and a royalty of five per cent of the sales price of any items using the team name or logo. The customer expects that the entity will continue to play games and provide a competitive team.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of IFRS 15. The entity concludes that its only performance obligation is to transfer the licence. The additional activities associated with the licence (ie continuing to play games and provide a competitive team) do not directly transfer a good or service to the customer because they are part of the entity's promise to grant the licence.

The entity assesses the nature of the entity's promise to transfer the licence in accordance with paragraph B58 of IFRS 15. In assessing the criteria the entity considers the following:

(a) the entity concludes that the customer would reasonably expect that the entity will undertake activities that will significantly affect the intellectual property (ie the team name and logo) to which the customer has rights. This is on the basis of the entity's customary business practice to undertake activities that support and maintain the value of the name and logo such as continuing to play and providing a competitive team. The entity determines that the ability of the customer to obtain benefit from the name and logo is substantially derived from, or dependent upon, the expected activities of the entity. In addition, the entity observes that because some of its consideration is dependent on the success of the customer (through the sales-based royalty), the entity has a shared economic interest with the customer, which indicates that the customer will expect the entity to undertake those activities to maximise earnings.

(b) the entity observes that the rights granted by the licence (ie the use of the team's name and logo) directly expose the customer to any positive or negative effects of the entity's activities.

(c) the entity also observes that even though the customer may benefit from the activities through the rights granted by the licence, they do not transfer a good or service to the customer as those activities occur.

The entity concludes that the criteria in paragraph B58 of IFRS 15 are met and the nature of the entity's promise to grant the licence is to provide the customer with access to the entity's intellectual property as it exists throughout the licence period. Consequently, the entity accounts for the promised licence as a performance obligation satisfied over time (ie the criterion in paragraph 35(a) of IFRS 15 is met).

Extract from IFRS 15 (cont'd)

The entity then applies paragraphs 39–45 of IFRS 15 to determine a measure of progress that will depict the entity's performance. For the consideration that is in the form of a sales-based royalty, paragraph B63 of IFRS 15 applies because the sales-based royalty relates solely to the licence, which is the only performance obligation in the contract. The entity concludes that recognition of the CU2 million fixed consideration as revenue rateably over time plus recognition of the royalty as revenue as and when the customer's sales of items using the team name or logo occur reasonably depicts the entity's progress towards complete satisfaction of the licence performance obligation.

In Example 61 above, the fixed consideration of CU2 million is an explicit term in the contract with the customer. In some contracts, fixed consideration may be implied, such as when a guaranteed minimum amount of royalties is part of the transaction price.

In addition, as discussed in Question 8-3 in section 8.3.1, many licences that provide a right to access intellectual property may constitute a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer (e.g., a series of distinct periods of access to intellectual property, such as monthly access or quarterly access). In cases where the criteria for a performance obligation to be accounted for as a series of distinct goods or services have been met, an entity needs to consider whether any variable consideration in the contract (e.g., sales-based or usage-based royalties) should be allocated directly to the distinct periods of access, if the criteria for certain allocation exceptions are met. The allocation of sales-based or usage-based royalties in this manner generally results in the recognition of royalties as revenue when (or as) the customer's underlying sales or usage occurs.

An entity may need to apply significant judgement to determine the appropriate pattern of revenue recognition for royalties received on a licence that provides a right to access intellectual property.

Frequently asked questions

Question 8-4: Can the recognition constraint for sales-based or usage-based royalties be applied to royalties that are paid in consideration for sales of intellectual property (rather than just licences of intellectual property)?

No. As noted in the Basis for Conclusions, the Board discussed but decided not to expand the scope of the royalty recognition constraint to include sales of intellectual property. The Board also stated that the royalty recognition constraint is intended to apply only to limited circumstances (i.e., those circumstances involving licences of intellectual property) and, therefore, entities cannot apply it by analogy to other types of transactions.[366]

[366] IFRS 15.BC421, BC421F.

Frequently asked questions (cont'd)

Question 8-5: If a contract for a licence of intellectual property includes payments with fixed amounts (e.g., milestone payments) that are determined by reference to sales-based or usage-based thresholds, would the royalty recognition constraint need to be applied?

Yes. We generally believe the royalty recognition constraint would apply to fixed amounts of variable consideration (i.e., fixed amounts of consideration that are contingent on the occurrence of a future event), such as milestone payments, provided the amounts are determined by reference to sales-based or usage-based thresholds. This is the case even if those payments are not referred to as 'royalties' under the terms of the contract. However, entities need to apply judgement and carefully evaluate the facts and circumstances of their contracts for licences of intellectual property to determine whether these types of payments should be accounted for using the royalty recognition constraint.

Consider the following example:

Illustration 8-1 – Application of the royalty recognition constraint to a milestone payment

An entity enters into a contract to grant a customer a right to use the entity's intellectual property. The contract contains payment terms that include a CU10 million milestone payment that is payable to the entity once the customer has achieved sales of CU100 million associated with the licence.

The entity determines that the milestone payment is based on the customer's subsequent sales and represents variable consideration because it is contingent on the customer's sales reaching CU100 million. The entity accounts for the CU10 million milestone payment in accordance with the royalty recognition constraint and only recognises revenue for the milestone payment once the customer's sales reach CU100 million.

Question 8-6: If a contract for a licence of intellectual property includes a milestone payment based on the first commercial sale, should the royalty recognition constraint be applied?

Yes, we generally believe it would be acceptable for an entity to apply the royalty recognition constraint to a milestone payment that is contingent on the customer's first commercial sale of a product using the entity's intellectual property. This is because the milestone payment is linked to a sales-based or usage-based threshold (i.e., the milestone payment is based on the customer's sales).

Frequently asked questions (cont'd)

Consider the following example:

Illustration 8-2 – Application of the royalty recognition constraint to a milestone payment based on the first commercial sale

An entity enters into a contract to grant a customer a right to use the entity's intellectual property. The contract contains payment terms that include a CU10 million milestone payment that is payable to the entity upon the customer's first commercial sale of a product that uses the entity's intellectual property.

The entity determines that the milestone payment is based on the customer's subsequent sales and represents variable consideration because it is contingent on the customer's first commercial sale. It accounts for the CU10 million milestone payment in accordance with the royalty recognition constraint and only recognises revenue for the milestone payment upon the customer's first commercial sale.

In contrast, if a milestone payment is contingent on metrics that are not determined by reference to sales-based or usage-based thresholds and that are substantive (e.g., regulatory approval), the royalty recognition constraint must not be applied because it is not linked to a sales-based or usage-based threshold (i.e., the milestone payment is not based on the customer's sales). Rather, the general variable consideration requirements need to be applied.

As discussed in Question 5-12, we expect entities to conclude, in many instances, that milestone payments contingent on regulatory approval (e.g., regulatory approval of a new drug) are constrained, preventing them from recognising these payments until the uncertainty associated with the payments is resolved.

Question 8-7: Can an entity recognise revenue for sales-based or usage-based royalties for licences of intellectual property on a lag if actual sales or usage data is not available at the end of a reporting period?

The standard requires that sales-based or usage-based royalties promised in exchange for licences of intellectual property be recognised as revenue at the later of when: (1) the subsequent sales or usage occurs and (2) the performance obligation to which the sales-based or usage-based royalties relates has been satisfied (or partially satisfied). Therefore, after the conditions in the royalty recognition constraint application guidance have been met (i.e., the underlying sales or usage has occurred and the performance obligation to which the royalties relate has been satisfied (or partially satisfied), we believe that licensors without actual sales or usage data from the licensee need to make an estimate of royalties earned in the current reporting period.

Frequently asked questions (cont'd)

Question 8-8: How does a minimum guarantee affect the recognition of sales-based or usage-based royalties promised in exchange for a licence of intellectual property that is satisfied at a point in time? [FASB TRG meeting 7 November 2016 - Agenda paper no. 58]

FASB TRG members generally agreed that a minimum guaranteed amount of sales based or usage-based royalties promised in exchange for a licence of intellectual property that is satisfied at a point in time (IFRS: right-to-use licence; US GAAP: licence of functional intellectual property) would need to be recognised as revenue at the point in time that the entity transfers control of the licence to the customer (see section 8.3.2). Any royalties above the fixed minimum would be recognised in accordance with the royalty recognition constraint (i.e., at the later of when the sale or usage occurs or when the entity satisfies the performance obligation to which some or all of the royalty has been allocated).

Question 8-9: How does a minimum guarantee affect the recognition of sales-based or usage-based royalties promised in exchange for a licence of intellectual property that is satisfied over time? [FASB TRG meeting 7 November 2016 - Agenda paper no. 58]

FASB TRG members generally agreed that various recognition approaches could be acceptable for minimum guarantees promised in exchange for licences of intellectual property that are satisfied over time (IFRS: right-to-access licences; US GAAP: licences of symbolic intellectual property, see section 8.3.1). This is because, as the FASB staff noted in the TRG agenda paper, this question is asking what is an appropriate measure of progress for such contracts and the standard permits reasonable judgement when selecting a measure of progress. Because the standard does not prescribe a single approach that must be applied in all circumstances in which a sales-based or usage-based royalty is promised in exchange for a licence of intellectual property and the contract includes a minimum guaranteed amount, an entity should consider the nature of its arrangements and make sure that the measure of progress it selects does not override the core principle of the standard that "an entity shall recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services".[367] An entity would need to disclose the accounting policy it selects because it is likely that this would affect the timing of revenue recognised.

The agenda paper describes two approaches. Under one approach, an entity would estimate the total consideration (i.e., the fixed minimum and the variable consideration from future royalties) and apply an appropriate measure of progress to recognise revenue as the entity satisfies the performance obligation, subject to the royalty recognition constraint. Alternatively, under the other approach, an entity could apply a measure of progress to the fixed consideration and begin recognising the variable component after exceeding the fixed amount on a cumulative basis.

The first approach can be applied in two different ways, as follows:

- View A: If an entity expects royalties to exceed the minimum guarantee, the entity may determine that an output-based measure is an appropriate measure of progress and apply the right-to-invoice practical expedient (i.e., IFRS 15.B16, see section 7.1.4.A) because the royalties due for each period correlate directly with the value to the customer of the entity's performance each period. As a result of applying the practical expedient for recognising revenue, the entity would not

[367] IFRS 15.2.

Frequently asked questions (cont'd)

need to estimate the expected royalties beyond determining whether it expects, at contract inception, that the royalties will exceed the minimum guarantee. However, the entity would be required to update that assessment at the end of each reporting period. It is important to note that this view is likely to be appropriate if the entity expects cumulative royalties to exceed the minimum guarantee.

- View B: An entity estimates the transaction price for the performance obligation (including both fixed and variable consideration) and recognises revenue using an appropriate measure of progress, subject to the royalty recognition constraint. If an entity does not expect cumulative royalties to exceed the minimum guarantee, the measure of progress is applied to the minimum guarantee since the transaction price will at least equal the fixed amount.

The second approach can be summarised, as follows:

- View C: An entity recognises the minimum guarantee (i.e., the fixed consideration) using an appropriate measure of progress and recognises royalties only when cumulative royalties exceed the minimum guarantee.

The FASB staff noted in the TRG agenda paper that, in order for an entity to apply View C, the over-time licence would have to be considered a series of distinct goods or services (i.e., a series of distinct time periods) and the variable consideration (i.e., the royalties in excess of the minimum guarantee) would have to be allocated to the distinct time periods to which they relate.

To illustrate the application of these views, the following example has been adapted from one included in the FASB TRG agenda paper:

Example of accounting for a licence of intellectual property that is satisfied over time in exchange for a minimum guarantee and sales-based royalty

An entity enters into a five-year arrangement to licence a trademark. The trademark is determined to be a licence of intellectual property that is satisfied over time (IFRS: right-to-access licence; US GAAP: licence of symbolic intellectual property). The licence requires the customer to pay a sales-based royalty of 5% of its gross sales associated with the trademark. However, the contract includes a guarantee that the entity will receive a minimum of CU5 million for the entire five-year period.

The customer's actual gross sales associated with the trademark and the related royalties each year are, as follows (this information is not known at the beginning of the contract):

Year 1 – CU15 million (royalties equal CU750,000)

Year 2 – CU30 million (royalties equal CU1.5 million)

Year 3 – CU40 million (royalties equal CU2 million)

Year 4 – CU20 million (royalties equal CU1 million)

Year 5 – CU60 million (royalties equal CU3 million)

Total royalties equal CU8.25 million.

View A: The entity expects total royalties to exceed the minimum guarantee. The entity determines that an output-based measure is an appropriate measure of progress and applies the right-to-invoice practical expedient because the royalties due for each period correlate directly with the value to the customer of the entity's performance for

Frequently asked questions (cont'd)

Example of accounting for a licence of intellectual property that is satisfied over time in exchange for a minimum guarantee and sales-based royalty (cont'd)

each period. The entity recognises revenue from the sales-based royalty when the customer's subsequent sales occur.

(in 000s)	Year 1	Year 2	Year 3	Year 4	Year 5
Royalties received	750	1,500	2,000	1,000	3,000
Annual revenue	750	1,500	2,000	1,000	3,000
Cumulative revenue	750	2,250	4,250	5,250	8,250

View B: The entity estimates the transaction price (including fixed and variable consideration) for the contract. The entity determines that time elapsed is an appropriate measure of progress and recognises revenue rateably over the five-year term of the contract, subject to the royalty recognition constraint (i.e., cumulative revenue recognised cannot exceed the cumulative royalties received once the minimum guarantee has been met).

(in 000s)	Year 1	Year 2	Year 3	Year 4	Year 5
Royalties received	750	1,500	2,000	1,000	3,000
Royalties (cumulative)	750	2,250	4,250	5,250	8,250
Fixed + Variable (rateable)[a]	1,650	1,650	1,650	1,650	1,650
Annual revenue	1,650	1,650	1,650	300	3,000
Cumulative revenue	1,650	3,300	4,950	5,250[b]	8,250

a. Assuming the entity's estimated transaction price (including both fixed and variable consideration) is CU8.25 million, the annual revenue that could be recognised is CU1.65 million (CU8.25 million divided by five years, being contract term).

b. In Year 4, the cumulative revenue using a time-elapsed measure of progress of CU6.6 million (CU4.95 million plus CU1.65 million) exceeds the cumulative royalties received (CU5.25 million). As such, the total cumulative revenue recognised through to the end of Year 4 is constrained to the total cumulative royalties received of CU5.25 million.

View C: The entity recognises the minimum guarantee (i.e., the fixed consideration) using an appropriate measure of progress and recognises royalties only when cumulative royalties exceed the minimum guarantee. The entity determines that time elapsed is an appropriate measure of progress.

The entity applies the royalty recognition constraint to the sales-based royalties that are in excess of the minimum guarantee (i.e., recognise the royalties as revenue when the minimum guarantee is exceeded on a cumulative basis). The variable consideration (royalties in excess of the minimum guarantee) is allocated to the distinct periods using the variable consideration allocation exception (i.e., IFRS 15.85, see section 6.3).

Frequently asked questions (cont'd)

Example of accounting for a licence of intellectual property that is satisfied over time in exchange for a minimum guarantee and sales-based royalty (cont'd)

As previously discussed, the FASB staff noted in the TRG agenda paper that, in order for an entity to apply View C, the over-time licence would have to be considered a series of distinct goods or services (i.e., a series of distinct time periods) and the variable consideration (i.e., the royalties that are in excess of the minimum guarantee) would have to be allocated to the distinct time periods to which they relate.

(in 000s)	Year 1	Year 2	Year 3	Year 4	Year 5
Royalties received	750	1,500	2,000	1,000	3,000
Royalties (cumulative)	750	2,250	4,250	5,250	8,250
Fixed (rateable)[a]	1,000	1,000	1,000	1,000	1,000
Annual revenue	1,000	1,000	1,000	1,250[b]	4,000[c]
Cumulative revenue	1,000	2,000	3,000	4,250	8,250

a. Because the minimum guarantee is CU5 million over the contract term, the annual revenue (excluding royalties that are in excess of the minimum guarantee) is CU1 million (CU5 million divided by five years, being the contract term).

b. In Year 4, the cumulative royalties received (CU5.25 million) exceed the total minimum guarantee (CU5 million) by CU250,000. As such, the annual revenue recognised in Year 4 is CU1.25 million (CU1 million annual revenue plus CU250,000 of royalties in excess of the minimum guarantee).

c. In Year 5, the annual revenue recognised (CU4 million) is calculated as the CU1 million annual revenue plus the royalties for that year (CU3 million) since the royalties exceeded the minimum guarantee in Year 4.

The FASB staff noted in the TRG agenda paper that other measures of progress, in addition to those set out above, could be acceptable because the standard permits entities to use judgement in selecting an appropriate measure of progress and that judgement is not limited to the views in the TRG agenda paper. However, the staff emphasised that it would not be acceptable for entities to apply any measure of progress in any circumstance. For example, the FASB staff noted it would not be acceptable to apply multiple measures of progress to a single performance obligation, such as one measure for fixed consideration and a different one for variable consideration. The staff also thought it would not be appropriate for an entity to apply the breakage model in IFRS 15.B46 (see section 7.9) because it is likely that a customer would not have an unexercised right in a licence arrangement if the entity is providing the customer with access to its intellectual property over the entire term of the arrangement. Another approach that would not be appropriate, according to the FASB staff, is one that ignores the royalties recognition constraint application guidance in IFRS 15.B63, which requires revenue to be recognised at the later of when: (1) the subsequent sale or usage occurs; or (2) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated is satisfied (in whole or in part) (discussed above in section 8.5).

Frequently asked questions (cont'd)

Question 8-10: Can entities apply the royalty recognition constraint for sales-based or usage-based royalties if they do not own the intellectual property or control the intellectual property as a principal in the arrangement?

Yes, we generally believe entities can apply the royalty recognition constraint if their revenue is based on a sales-based or usage-based royalty from a licence of intellectual property, but they do not own or control the intellectual property as a principal in the arrangement.

Consider the following example:

Illustration 8-3 – Application of the royalty recognition constraint as an agent

University U has intellectual property for its logo. Company Z, acting as an agent for University U, identifies an apparel company looking to license University U's logo to put it on merchandise. University U is paid a royalty based on sales and usage of its intellectual property (the logo) by the licensee (the apparel company). Company Z receives a portion of the royalty earned by University U. Company Z does not control the intellectual property at any point during the arrangement and its ability to receive consideration from University U depends on the licensing of University U's intellectual property. We believe that application of the royalty recognition constraint may be appropriate in this example because the royalties earned by University U and, in effect, the amount Company Z expects to be entitled to receive, are directly tied to the usage of the intellectual property.

It is important to note that this view applies only to licences of intellectual property for which some or all of the consideration received by both the licensor and the agent is in the form of a sales-based or usage-based royalty. Entities cannot analogise to this view for other situations. Entities should disclose their use of the royalty recognition constraint because it is likely to effect the amount and timing of revenue recognised.

Question 8-11: Can entities recognise sales-based or usage-based royalties before the sale or usage of the intellectual property occurs if they have historical information that is highly predictive of future royalty amounts?

No. In accordance with IFRS 15.B63-B63B, revenue from a sales-based or usage-based royalty promised in exchange for a licence of intellectual property is recognised at the later of when: (1) the subsequent sale or usage occurs; or (2) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (in whole or in part). Revenue recognition cannot be accelerated even if an entity has historical information that is highly predictive of future royalty amounts. That is, the use of the royalty recognition constraint is not optional.

Frequently asked questions (cont'd)

Question 8-12: Should an entity apply the royalty recognition constraint when the royalty is calculated on a financial metric that is not solely based on sales or usage?

In certain circumstances, we believe the royalty recognition constraint can be applied when the royalty is calculated on a financial metric that is not solely based on sales or usage. For example, a licensor may be entitled to a fee based on a fixed percentage of gross profit generated by the licensee for the entire term of the contract. We believe that a metric such as gross profit (commonly defined as sales less cost of goods sold) is largely attributable to sales. Therefore, if the royalty is calculated using gross profit, the royalty recognition constraint may be applied. Judgement will be required to determine whether the royalty recognition constraint can be applied if the royalty is based on a different financial metric that is not solely based on sales or usage.

9. Other measurement and recognition topics

9.1 Warranties

Warranties are commonly included in arrangements to sell goods or services. They may be explicitly included in the contractual arrangement with a customer or may be required by law or regulation. In addition, an entity may have established an implicit policy of providing warranty services to maintain a desired level of satisfaction among its customers. Whether explicit or implicit, warranty obligations extend an entity's obligations beyond the transfer of control of the good or service to the customer, requiring it to stand ready to perform under the warranty over the life of the warranty obligation.

The price of a warranty may be included in the overall purchase price or listed separately as an optional product. While the standard notes that the nature of a warranty can vary significantly across industries and contracts, it identifies two types of warranties:

- Warranties that promise the customer that the delivered product is as specified in the contract (called 'assurance-type warranties')
- Warranties that provide a service to the customer in addition to assurance that the delivered product is as specified in the contract (called 'service-type warranties')

9.1.1 Determining whether a warranty is an assurance-type or service-type warranty (updated October 2018)

If the customer has the option to purchase the warranty separately or if the warranty provides a service to the customer, beyond fixing defects that existed at the time of sale, IFRS 15.B29 states that the entity is providing a service-type warranty. Otherwise, it is an assurance-type warranty, which provides the customer with assurance that the product complies with agreed-upon specifications. In some cases, it may be difficult to determine whether a warranty provides a customer with a service in addition to the assurance that the delivered product is as specified in the contract. To help entities make that assessment, the standard provides the following application guidance:

Extract from IFRS 15

B31. In assessing whether a warranty provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, an entity shall consider factors such as:

(a) Whether the warranty is required by law—if the entity is required by law to provide a warranty, the existence of that law indicates that the promised warranty is not a performance obligation because such requirements typically exist to protect customers from the risk of purchasing defective products.

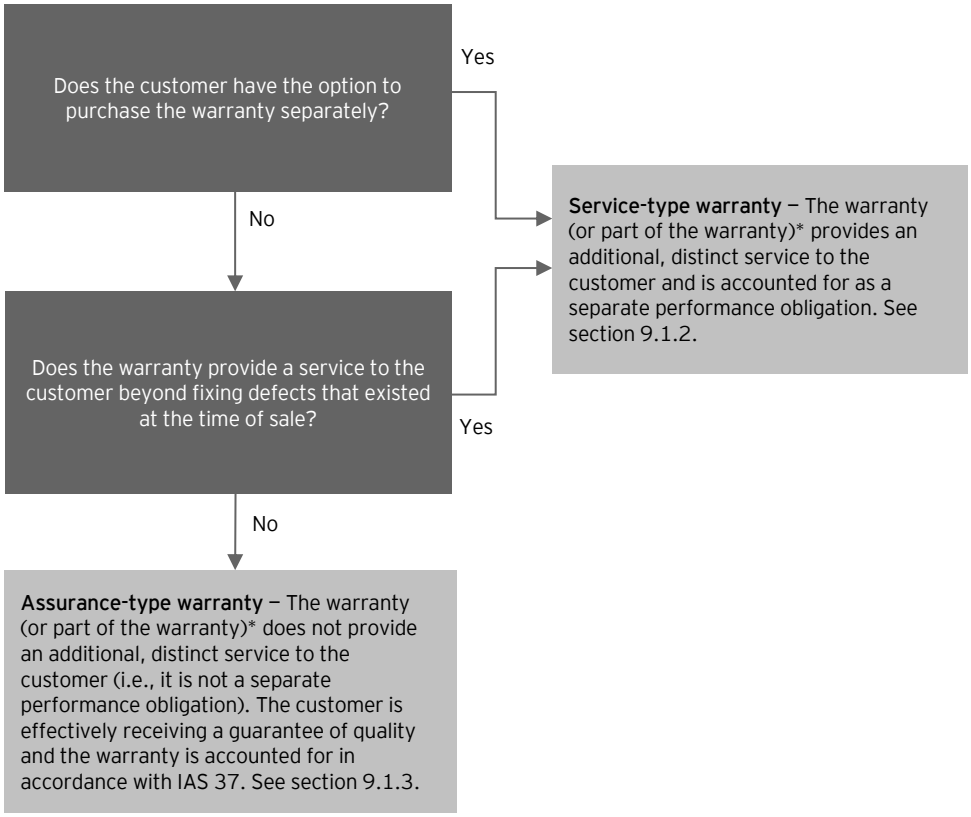
(b) The length of the warranty coverage period—the longer the coverage period, the more likely it is that the promised warranty is a performance obligation because it is more likely to provide a service in addition to the assurance that the product complies with agreed-upon specifications.

(c) The nature of the tasks that the entity promises to perform—if it is necessary for an entity to perform specified tasks to provide the assurance that a product complies with agreed-upon specifications (for example, a return shipping service for a defective product), then those tasks likely do not give rise to a performance obligation.

Extract from IFRS 15 (cont'd)

B33. 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.

The following flow chart illustrates these requirements:



*Some contracts may include both assurance-type and service-type warranties. See section 9.1.4 for further discussion.

How we see it

Entities may need to exercise significant judgement when determining whether a warranty is an assurance-type or service-type warranty. An entity's evaluation may be affected by several factors including common warranty practices within its industry and the entity's business practices related to warranties. For example, consider an automotive manufacturer that provides a five-year warranty on a luxury vehicle and a three-year warranty on a standard vehicle. The manufacturer may conclude that the longer warranty period is not an additional service because it believes the materials used to construct the luxury vehicle are of a higher quality and that latent defects would take longer to appear. In contrast, the manufacturer may also consider the length of the warranty period and the nature of the services provided under the warranty and conclude that the five-year warranty period, or some portion of it, is an additional service that needs to be accounted for as a service-type warranty. The standard excludes assurance-type warranties, which are accounted for in accordance with IAS 37.

Frequently asked questions

Question 9-1: How does an entity evaluate whether a product warranty is a service-type warranty (i.e., a performance obligation) when it is not separately priced? [TRG meeting 30 March 2015 – Agenda paper no. 29]

TRG members generally agreed that the evaluation of whether a warranty provides a service (in addition to the assurance that the product complies with agreed specifications) requires judgement and depends on the facts and circumstances. There is no bright line in the standard on what constitutes a service-type warranty, beyond it being separately priced.

However, IFRS 15.B31 includes three factors that need to be considered in each evaluation: (1) whether the warranty is required by law; (2) the length of the warranty coverage; and (3) the nature of the tasks that the entity promises to perform. Consider the following example from the TRG agenda paper, which illustrates the factors an entity considers in assessing whether a product warranty is a service-type warranty:

Example of consideration of service-type warranty factors

A luggage company provides a life-time warranty to repair broken or damaged baggage free of charge.

The luggage company evaluates the three factors in IFRS 15.B31 and determines that the warranty is a performance obligation in addition to the assurance that the product complies with agreed-upon specifications because: (1) there is no law that requires the luggage company to make a promise for the lifetime of the product; (2) the length of the warranty is for the life of the baggage; and (3) the tasks include both repairs to baggage that does not meet the promised specifications and repairs for broken or damaged baggage.

Furthermore, the TRG agenda paper emphasised that entities need to evaluate each type of warranty offered to determine the appropriate accounting treatment.

Frequently asked questions (cont'd)

Question 9-2: How would an entity account for repairs provided outside the warranty period?

An entity must to consider all facts and circumstances, including the factors in IFRS 15.B31 (e.g., the nature of the services provided, the length of the implied warranty period) to determine whether repairs provided outside the warranty period need to be accounted for as an assurance-type or service-type warranty. Sometimes, entities provide these services as part of their customary business practices, in addition to providing assurance-type warranties for specified periods of time. For example, an equipment manufacturer may give its customers a standard product warranty that provides assurance that the product complies with agreed-upon specifications for one year from the date of purchase. However, the entity may also provide an implied warranty by frequently repairing products for free after the one-year standard warranty period has ended. See section 4.1 for a discussion of implied promises in a contract with a customer.

If the entity determines that the repairs made during the implied warranty period generally involve defects that existed when the product was sold and the repairs occur shortly after the assurance warranty period, the entity may conclude that the repairs are covered by an assurance-type warranty. That is, the term of the assurance-type warranty may be longer than that stated in the contract. However, all facts need to be considered to reach a conclusion.

If the entity determines that the repairs provided outside the warranty period are covered by a service-type warranty (because the entity is providing a service to the customer beyond fixing defects that existed at the time of sale), it also needs to consider whether the term of the service-type warranty is longer than that stated in the contract.

Question 9-3: Should an entity account for a customer's return of a defective item in exchange for compensation (i.e., not for a replacement item) as a right of return or an assurance-type warranty?

We believe that an entity should account for the right to return a defective item in return for cash (instead of a replacement item) under the right of return application guidance in IFRS 15.B20-B27, rather than as an assurance-type warranty. The Basis for Conclusions states that "... the boards decided that an entity should recognise an assurance-type warranty as a separate liability to replace or repair a defective product".[368] This description of an assurance-type warranty does not include defective products that are returned for a refund. It only contemplates defective products that are replaced or repaired. See section 5.4.1 for a discussion of rights of return.

However, there may be limited circumstances in which the cash paid to a customer for a defective item would need to be accounted for in accordance with the warranty application guidance, instead of as a right of return. For example, an entity may pay cash to a customer as reimbursement for third-party costs incurred to repair a defective item. In this case, the cash payment to the customer was incurred to fulfil the entity's warranty obligation. This assessment requires judgement and depends on the facts and circumstances.

Question 9-4: Should liquidated damages, penalties or compensation from other similar clauses be accounted for as variable consideration or warranty provisions under the standard?

See response to Question 5-4 in section 5.2.1.

[368] IFRS 15.BC376.

9.1.2 Service-type warranties (updated September 2019)

The Board determined that a service-type warranty represents a distinct service and is a separate performance obligation.[369] Therefore, using the relative stand-alone selling price of the warranty, an entity allocates a portion of the transaction price to the service-type warranty (see section 6). The entity then recognises the allocated revenue over the period in which the service-type warranty service is provided. This is because it is likely that the customer receives and consumes the benefits of the warranty as the entity performs (i.e., it is likely that the warranty performance obligation is satisfied over time in accordance with IFRS 15.35(a), see section 7.1.1).

Judgement may be required to determine the appropriate pattern of revenue recognition associated with service-type warranties. For example, an entity may determine that it provides the warranty service continuously over the warranty period (i.e., the performance obligation is an obligation to 'stand ready to perform' during the stated warranty period). An entity that makes this determination is likely to recognise revenue rateably over the warranty period. An entity may also conclude that a different pattern of recognition is appropriate based on data it has collected about when it provides such services. For example, an entity may recognise little or no revenue in the first year of a three-year service-type warranty if its historical data indicates that it only provides warranty services in the second and third years of the warranty period.

The AICPA Audit and Accounting Guide, *Revenue Recognition*, provides non-authoritative guidance on how to determine the appropriate pattern of recognition for service-type warranties. The guidance says that, if an entity determines that it is standing ready to provide protection against damage, loss or malfunction of a product caused by various risks for the specified coverage period (i.e., provides assurance of use for the covered product for the coverage period that would include some level of involvement with the repair or replacement), it recognises revenue over the coverage period.

If an entity determines that it has promised to repair, arrange to repair or replace the product, it recognises revenue over the period in which it is expected to repair or replace the product. The period could extend beyond the coverage period if services to repair or replace the product are expected to be provided after the coverage period ends.

For example, a claim may be filed at the end of a one-year period, but it is fulfilled after the coverage period ends. While the activities in both instances may be similar, the nature of the promise to the customer determines the period of recognition.[370] Section 7.1.4 describes considerations for determining the appropriate pattern of revenue recognition, including those for stand-ready obligations. If payment for the service-type warranty is received upfront, an entity should also evaluate whether a significant financing component exists (see section 5.5).

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[369] IFRS 15.BC371.

[370] See AICPA guide, *Revenue Recognition*, Chapter 1, *General Accounting Considerations*, paragraphs 1.63 -1.75.

In some instances, entities that sell service-type warranties will buy insurance to protect themselves against the potential costs of performing under such warranties. Although the anticipated insurance proceeds might offset any costs that the entity might incur, immediate revenue recognition for the price of the service-type warranty is not appropriate. The entity has not been relieved of its obligation to perform under the terms of the warranty contract and, therefore, a liability still exists. Accordingly, the warranty obligation and any proceeds related to the insurance coverage need to be accounted for separately (unless the insurer has legally assumed the warranty obligation and the customer has acknowledged that fact).

As discussed in section 6.1, stand-alone selling prices are determined at contract inception and are not updated to reflect changes between contract inception and when performance is complete. Accordingly, an entity would not change the amount of transaction price it originally allocated to the service-type warranty at contract inception. This would be the case, even if, for example, an entity may discover two months after a product is shipped that the cost of a part acquired from a third-party manufacturer has tripled and that, as a result, it will cost the entity significantly more to replace that part if a warranty claim is made. However, for future contracts involving the same warranty, the entity would need to determine whether to revise the stand-alone selling price because of the increase in the costs to satisfy the warranty and, if so, use that revised price for future allocations (see section 6.1.3).

9.1.3 Assurance-type warranties (updated October 2018)

The Board concluded that assurance-type warranties do not provide an additional good or service to the customer (i.e., they are not separate performance obligations). By providing this type of warranty, the selling entity has effectively provided a guarantee of quality. In accordance with IFRS 15.B30, these types of warranties are accounted for as warranty obligations and the estimated cost of satisfying them is accrued in accordance with the requirements in IAS 37.[371] Once recorded, the warranty liability is assessed on an ongoing basis in accordance with IAS 37.

An entity might recognise revenue for sales of goods or services, including assurance-type warranties when control of the goods or services is transferred to the customer, assuming that the arrangement meets the criteria to be considered a contract under IFRS 15 (see section 3.1) and the entity's costs of honouring its warranty obligations are reasonably estimable.

Assurance-type warranties are accounted for outside of the scope of IFRS 15. Therefore, if an entity elects to use a costs incurred measure of progress for over time revenue recognition of the related good or service, the costs of satisfying an assurance-type warranty are excluded (i.e., excluded from both the numerator and the denominator in the measure of progress calculation – see section 7.1.4 for further discussion on measuring progress over time).

[371] IFRS 15.BC376.

9.1.4 Contracts that contain both assurance and service-type warranties.

Some contracts may include both an assurance-type warranty and a service-type warranty. However, if an entity provides both an assurance-type and service-type warranty within a contract and the entity cannot reasonably account for them separately, the warranties are accounted for as a single performance obligation (i.e., revenue would be allocated to the combined warranty and recognised over the period the warranty services are provided).

When an assurance-type warranty and a service-type warranty are both present in a contract with a customer, an entity is required to accrue for the expected costs associated with the assurance-type warranty and defer the revenue for the service-type warranty, as illustrated below:

Illustration 9-1 — Service-type and assurance-type warranties

An entity manufactures and sells computers that include an assurance-type warranty for the first 90 days. The entity offers an optional 'extended coverage' plan under which it will repair or replace any defective part for three years from the expiration of the assurance-type warranty. Since the optional 'extended coverage' plan is sold separately, the entity determines that the three years of extended coverage represent a separate performance obligation (i.e., a service-type warranty).

The total transaction price for the sale of a computer and the extended warranty is CU3,600. The entity determines that the stand-alone selling prices of the computer and the extended warranty are CU3,200 and CU400, respectively. The inventory value of the computer is CU1,440. Furthermore, the entity estimates that, based on its experience, it will incur CU200 in costs to repair defects that arise within the 90-day coverage period for the assurance-type warranty. As a result, the entity will record the following entries:

Dr. Cash/Trade receivables	CU3,600	
Dr. Warranty expense	CU200	
Cr. Accrued warranty costs (assurance-type warranty)		CU200
Cr. Contract liability (service-type warranty)		CU400
Cr. Revenue		CU3,200

To record revenue and liabilities related to warranties.

Dr. Cost of goods sold	CU1,440	
Cr. Inventory		CU1,440

To relieve inventory and recognise cost of goods sold.

The entity derecognises the accrued warranty liability associated with the assurance-type warranty as actual warranty costs are incurred during the first 90 days after the customer receives the computer. The entity recognises the contract liability associated with the service-type warranty as revenue during the contract warranty period and recognises the costs associated with providing the service-type warranty as they are incurred. The entity would need to be able to determine whether the repair costs incurred are applied against the warranty reserve it had already established for claims that occur during the first 90 days or recognised as an expense as incurred.

Accounting for both assurance-type warranties and service-type warranties in the same transaction may be complex. Entities may need to develop processes to match individual warranty claims with the specific warranty plans so that claims can be analysed for the appropriate accounting treatment. This individual assessment of warranty claims is necessary because the assurance-type warranty costs will have been accrued previously, while the service-type warranty costs are expenses that need to be recognised in the period in which they are incurred, as illustrated below:

Illustration 9-2 — Service-type and assurance-type warranty costs

Assume the same facts as in Illustration 9-1, but assume the entity has sold 500 computers during the year. In January of the following year, CU10,000 of warranty claims are submitted by customers. The entity analyses each claim and identifies the specific computer sale to which the claims relate. The entity needs to do this in order to determine eligibility under the warranty plans and the appropriate accounting treatment.

The entity determines that a portion of the claims, costing CU2,500 for repair and replacement parts, are covered by the assurance-type warranty plan. As shown above in Illustration 9-1, the expected cost of each assurance-type warranty was accrued at the time of the sale. The entity records the following entry to derecognise a portion of the warranty liability:

Dr. Accrued warranty costs (assurance-type warranty)	CU2,500	
Cr. Cash		CU2,500

To derecognise the assurance-type warranty liability as the costs are incurred.

The entity also determines that a portion of the claims, costing CU7,000 for repair and replacement parts, are eligible under the 'extended coverage' plan (i.e., the service-type warranty). The entity records the following entry to recognise the costs associated with the service-type warranty:

Dr. Warranty expense	CU7,000	
Cr. Cash		CU7,000

To record the costs of the service-type warranty as the costs are incurred.

The entity also determines that CU500 of the claims are not eligible under either warranty plan. This is because the claims relate to incidents that occurred after the 90-day coverage period for the assurance-type warranty and the customers in those transactions did not purchase the extended warranty coverage. The entity rejects these customer claims.

9.2 Onerous contracts (updated October 2020)

Entities are required to use the requirements in IAS 37 to identify and measure onerous revenue contracts.[372] IAS 37 requires the following in respect of onerous contracts:

Extract from IAS 37

66. If an entity has a contract that is onerous, the present obligation under the contract shall be recognised and measured as a provision.

67. Many contracts (for example, some routine purchase orders) can be cancelled without paying compensation to the other party, and therefore there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties. Where events make such a contract onerous, the contract falls within the scope of this Standard and a liability exists which is recognised. Executory contracts that are not onerous fall outside the scope of this Standard.

68. This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

69. Before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets dedicated to that contract (see IAS 36).

In May 2020, the IASB issued amendments to IAS 37 clarifying that, when assessing whether a contract is onerous, "the cost of fulfilling a contract comprises the costs that relate directly to the contract" and consist of both "the incremental costs of fulfilling that contract" and "an allocation of other costs that relate directly to fulfilling contract".[373] The amendments are effective for periods beginning on or after 1 January 2022. Earlier application is permitted.

One significant impact of the coronavirus pandemic is the disruption to the global supply chain. For example, assume a manufacturing entity has contracts to sell goods at a fixed price and, because of the shutdown of its manufacturing facilities, as required by the local government, it cannot deliver the goods itself without procuring them from a third party at a significantly higher cost. If the entity determines the contract is onerous under IAS 37, the provision for the onerous contract will reflect the lower of the penalty for terminating the contract or the present value of the net cost of fulfilling the contract (i.e., the excess of the cost to procure the goods over the consideration to be received). Contracts need to be reviewed to determine whether there are any special terms that may relieve an entity of its obligations (e.g., *force majeure*). Contracts that can be cancelled without paying compensation to the other party do not become onerous as there is no obligation.

[372] IFRS 15.BC296.
[373] IAS 37.68A.

Frequently asked questions

Question 9-5: How does an entity account for an onerous contract with a customer when the contract includes more than one performance obligation that is satisfied over time consecutively?

Since the requirements for onerous contracts are outside the scope of IFRS 15, an entity's accounting for onerous contracts does not affect the accounting for its revenue from contracts with customers in accordance with IFRS 15.

Therefore, we believe that entities must use an 'overlay' approach, which consists of two steps:

1. Apply the requirements of IFRS 15 to measure progress in satisfying each performance obligation over time and account for the related costs when incurred in accordance with the applicable standards.
2. At the end of each reporting period, apply IAS 37 to determine if the remaining contract as a whole is onerous (i.e., considering whether the revenue still to be recognised is less than the costs yet to be incurred). If an entity concludes that the remaining contract is onerous, it recognises a provision to the extent that the amount of the unavoidable costs under the contract exceed the economic benefits to be received under it.

The effect of the provision is recognised as an expense, not as an adjustment to revenue. A change in the provision is recognised in profit or loss in accordance with IAS 37.59.

Since the definition of an onerous contract in IAS 37.10 refers to a contract, the unit of account in determining whether an onerous contract exists is the contract itself, rather than the performance obligations identified in accordance with IFRS 15. As a result, the entity must consider the entire remaining contract, including remaining revenue to be recognised for unsatisfied, or partially unsatisfied, performance obligations and the remaining costs to fulfil those performance obligations.

FASB differences

Under US GAAP, while requirements exist for some industries or for certain types of transactions, there is no general authoritative standard for when to recognise losses on onerous contracts and, if a loss is to be recognised, how to measure the loss. Accordingly, there is diversity in practice when such contracts are not within the scope of specific authoritative literature. The FASB retained existing requirements for situations in which an entity is expected to incur a loss on a contract (with certain consequential amendments to reflect the terminology of, and cross-references to, ASC 606, where appropriate). In addition, the FASB clarified that the assessment is performed at the contract level, but that an entity can perform it at the performance obligation level as an accounting policy election. As the FASB's requirements on onerous contracts are not the same as those in IAS 37, the accounting treatment in this area is not converged.

9.3 Contract costs (updated October 2018)

IFRS 15 specifies the accounting treatment for costs an entity incurs to obtain and fulfil a contract to provide goods or services to customers as discussed below. An entity only applies these requirements to costs incurred that relate to a contract with a customer that is within the scope of IFRS 15 (see section 2).

When an entity recognises capitalised contract costs under IFRS 15, any such assets must be presented separately from contract assets and contract liabilities (see section 10.1) in the statement of financial position or disclosed separately in the notes to the financial statements (assuming they are material). Furthermore, entities must consider the requirements in IAS 1 on classification of current assets when determining whether their contract cost assets are presented as current or non-current. See section 10.1 for a discussion on classification as current or non-current.

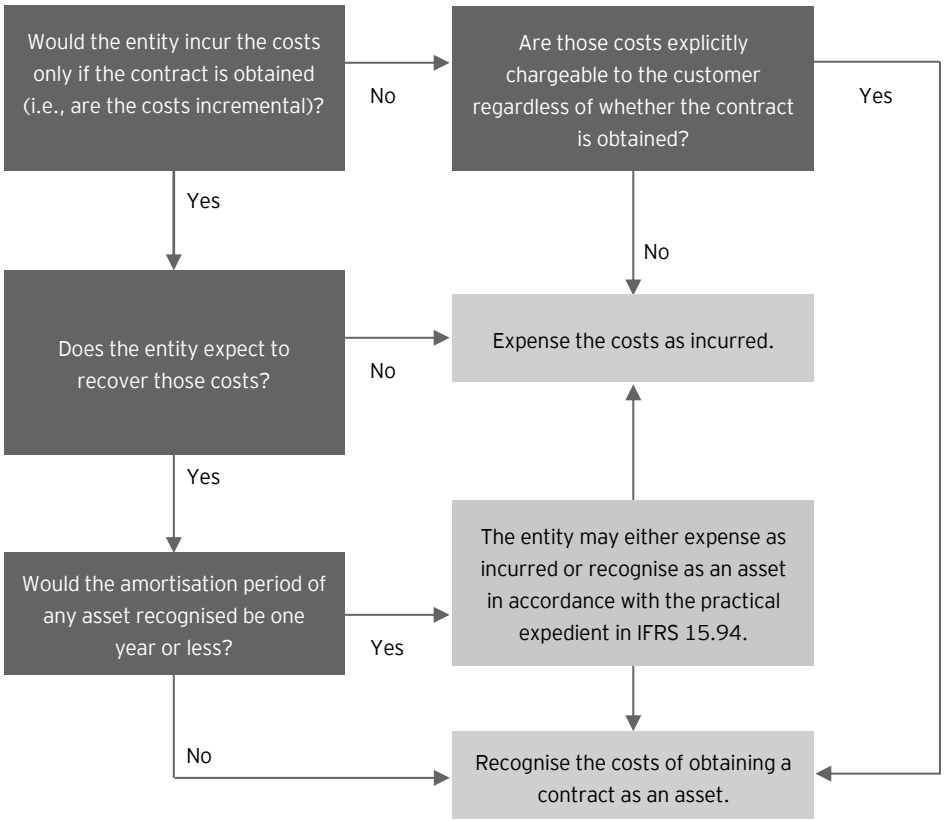
9.3.1 Costs to obtain a contract (updated October 2018)

Before applying the cost requirements in IFRS 15, entities need to consider the scoping provisions of the standard. Specifically, an entity needs to first consider whether the requirements on consideration payable to a customer under IFRS 15 apply to the costs (see section 5.7 for a discussion on accounting for consideration paid or payable to a customer).

For costs that are within the scope of the cost requirements in IFRS 15, the standard requires that incremental costs of obtaining a contract with a customer are recognised as an asset if the entity expects to recover them. An entity can expect to recover contract acquisition costs through direct recovery (i.e., reimbursement under the contract) or indirect recovery (i.e., through the margin inherent in the contract). Incremental costs are those that an entity would not have incurred if the contract had not been obtained.

Costs incurred to obtain a contract that are not incremental costs must be expensed as incurred, unless they are explicitly chargeable to the customer (regardless of whether the contract is obtained).

The following flow chart illustrates the requirements in IFRS 15:



In a FASB TRG agenda paper, the FASB staff suggested that, to determine whether a cost is incremental, an entity should consider whether it would incur the cost if the customer (or the entity) decides, just as the parties are about to sign the contract, that it will not enter into the contract. If the costs would have been incurred even if the contract is not executed, the costs are not incremental to obtaining that contract. The FASB staff also noted that the objective of this requirement is not to allocate costs that are associated in some manner with an entity's marketing and sales activity, but only to identify those costs that an entity would not have incurred if the contract had not been obtained. For example, salaries and benefits of sales employees that are incurred regardless of whether a contract is obtained are not incremental costs.[374]

[374] FASB TRG Agenda paper no. 57, *Capitalization and Amortization of Incremental Costs of Obtaining a Contract*, dated 7 November 2016.

Consider the following example from the FASB TRG agenda paper:[375]

Example of fixed employee salaries

An entity pays an employee an annual salary of CU100,000. The employee's salary is based on the number of contracts he or she signed for the prior year, as well as the number of contracts the employee is expected to sign for the current year. The employee's current year salary will not change if the number of contracts the employee actually signs differs from the projected number. However, any difference would affect the employee's salary in the following year.

FASB TRG members generally agreed that no portion of the employee's salary should be capitalised because it is not an incremental cost of obtaining a contract. The employee's salary would have been incurred regardless of the number of contracts the employee has actually signed during the current year.

The standard cites sales commissions as a type of an incremental cost that may require capitalisation under the standard. For example, commissions that are related to sales from contracts signed during the period may represent incremental costs that would require capitalisation. The standard does not explicitly address considerations for different types of commission programmes. Therefore, entities have to exercise judgement to determine whether sales commissions are incremental costs and, if so, the point in time when the costs would be capitalised. However, FASB TRG members generally agreed that an employee's title or level in the organisation or how directly involved the employee is in obtaining the contract, are not factors in assessing whether a sales commission is incremental. Consider the following example from a FASB TRG paper:[376]

Example of commissions paid to different levels of employees

An entity's salesperson receives a 10% sales commission on each contract that he or she obtains. In addition, the following employees of the entity receive sales commissions on each signed contract negotiated by the salesperson: 5% to the manager and 3% to the regional manager.

FASB TRG members generally agreed that all of the commissions are incremental because the commissions would not have been incurred if the contract had not been obtained. IFRS 15 does not distinguish between commissions paid to the employee(s) based on the function or the title of the employee(s) that receives a commission. It is the entity that decides which employee(s) are entitled to a commission as a result of obtaining a contract.

We believe that commissions that are paid to a third party in relation to sales from contracts that were signed during the period may also represent incremental costs that would require capitalisation. That is, commissions paid to third parties should be evaluated in the same manner as commissions paid to employees in order to determine whether they are required to be capitalised.

See Questions 9-6 and 9-7 below for additional examples on how to apply the incremental cost requirements. In addition, entities need to carefully evaluate all compensation plans, not just sales commission plans, to determine whether

[375] FASB TRG Agenda paper no. 57, *Capitalization and Amortization of Incremental Costs of Obtaining a Contract*, dated 7 November 2016.

[376] FASB TRG Agenda paper no. 57, *Capitalization and Amortization of Incremental Costs of Obtaining a Contract*, dated 7 November 2016.

any plans contain incremental costs that need to be capitalised. For example, payments under a compensation 'bonus' plan may be solely tied to contracts that are obtained. Such costs would be capitalised if they are incremental costs of obtaining a contract, irrespective of the title of the plan.

Illustration 9-3 — Commissions paid to a pool of funds

Assume that an entity has a compensation plan for support personnel in its sales department. As a group, the employees are entitled to a pool of funds calculated based on 2% of all new contracts signed during the monthly period. Once the amount of the pool is known, the amount paid to each individual employee is determined based on each employee's rating.

While the amount paid to each employee is discretionary (based on each employee's rating), the total amount of the pool is considered an incremental cost to obtain a contract because the entity owes that amount to the employees (as a group) simply because a contract was signed.

TRG members discussed the underlying principle for capitalising costs under the standard and generally agreed that entities first need to refer to the applicable liability standard (e.g., IAS 37, IFRS 9) to determine when they are required to accrue for certain costs. Entities then use the requirements in IFRS 15 to determine whether the related costs need to be capitalised. TRG members acknowledged that certain aspects of the cost requirements require entities to apply significant judgement in analysing the facts and circumstances and determining the appropriate accounting treatment.[377]

In addition, the IASB staff observed in a TRG agenda paper that incremental costs of obtaining a contract are not limited to initial incremental costs. Commissions recognised subsequent to contract inception (e.g., commissions paid on modifications, commissions subject to contingent events or clawback) because they did not meet the recognition criteria for liabilities at contract inception would still be considered for capitalisation as costs to obtain the contract when the liability is recognised. This would include costs related to contract renewals because, as mentioned in the TRG agenda paper, a renewal is a contract and there is nothing in the requirements for costs to obtain a contract that suggests a different treatment for contracts that are renewals of existing contracts. That is, the only difference between the two costs would be the timing of recognition based on when a liability has been incurred.[378] See Question 9-8 below for additional discussion of capitalising commissions paid on contract modifications.

Unlike many commissions, some incentive payments, such as bonuses and other compensation that are based on quantitative or qualitative metrics that are not related to contracts obtained (e.g., profitability, earnings per share (EPS), performance evaluations) are unlikely to meet the criteria for capitalisation, because they are not incremental to obtaining a contract. However, a legal contingency cost may be an incremental cost of obtaining a contract, for example, when a lawyer is entitled to be paid only upon the successful completion of a negotiation. Determining which costs must be capitalised under the standard may require judgement and it is possible that some contract

[377] TRG agenda paper no. 23, *Incremental costs of obtaining a contract*, dated 26 January 2015.

[378] TRG agenda paper no. 23, *Incremental costs of obtaining a contract*, dated 26 January 2015.

acquisition costs are determined to be incremental and others are not. Consider the following example from a FASB TRG agenda paper:[379]

Example of incremental and non-incremental costs for same contract

An entity pays a 5% sales commission to its employees when they obtain contracts with customers. An employee begins negotiating a contract with a prospective customer and the entity incurs CU5,000 in legal and travel costs in the process of trying to obtain the contract. The customer ultimately enters into a CU500,000 contract and, as a result, the employee receives a sales commission of CU25,000.

FASB TRG members generally agreed that the entity should only capitalise the commission paid to the employee of CU25,000. This cost is the only one that is incremental to obtaining the contract. While the entity incurs other costs that are necessary to facilitate a sale (e.g., legal, travel), those costs would have been incurred even if the contract had not been obtained.

The standard provides the following example regarding incremental costs of obtaining a contract:

Extract from IFRS 15

Example 36 — Incremental costs of obtaining a contract (IFRS 15.IE189-IE191)

An entity, a provider of consulting services, wins a competitive bid to provide consulting services to a new customer. The entity incurred the following costs to obtain the contract:

	CU
External legal fees for due diligence	15,000
Travel costs to deliver proposal	25,000
Commissions to sales employees	10,000
Total costs incurred	50,000

In accordance with paragraph 91 of IFRS 15, the entity recognises an asset for the CU10,000 incremental costs of obtaining the contract arising from the commissions to sales employees because the entity expects to recover those costs through future fees for the consulting services. The entity also pays discretionary annual bonuses to sales supervisors based on annual sales targets, overall profitability of the entity and individual performance evaluations. In accordance with paragraph 91 of IFRS 15, the entity does not recognise an asset for the bonuses paid to sales supervisors because the bonuses are not incremental to obtaining a contract. The amounts are discretionary and are based on other factors, including the profitability of the entity and the individuals' performance. The bonuses are not directly attributable to identifiable contracts.

The entity observes that the external legal fees and travel costs would have been incurred regardless of whether the contract was obtained. Therefore, in accordance with paragraph 93 of IFRS 15, those costs are recognised as expenses when incurred, unless they are within the scope of another Standard, in which case, the relevant provisions of that Standard apply.

[379] FASB TRG Agenda paper no. 57, *Capitalization and Amortization of Incremental Costs of Obtaining a Contract*, dated 7 November 2016.

As a practical expedient, the standard permits an entity to immediately expense contract acquisition costs when the asset that would have resulted from capitalising such costs would have been amortised within one year or less. It is important to note that the amortisation period for incremental costs may not always be the initial contract term. See section 9.3.3 for discussion of the amortisation of capitalised contract costs.

Frequently asked questions

Question 9-6: Does the timing of commission payments affect whether they are incremental costs? [FASB TRG meeting 7 November 2016 - Agenda paper no. 57]

It depends. FASB TRG members generally agreed that the timing of commission payments does not affect whether the costs would have been incurred if the contract had not been obtained. However, there could be additional factors or contingencies that would need to be considered in different commission plans that could affect the determination of whether all (or a portion) of a cost is incremental. Consider the following example from a FASB TRG agenda paper:

Example of timing of commission payments

An entity pays an employee a 4% sales commission on a CU50,000 signed contract with a customer. For cash flow management purposes, the entity pays the employee half of the commission (i.e., 2% of the total contract value) upon completion of the sale and the remainder in six months' time. The employee is entitled to receive the unpaid commission even if he or she is no longer employed by the entity when payment is due.

FASB TRG members generally agreed that the entity would capitalise the entire commission in this example (the timing of which would coincide with the recognition of the related liability). That is, the entity would not just capitalise the portion it paid immediately and expense the rest.

In this fact pattern, only the passage of time is required for the entity to pay the second half of the commission. For example, in some commission plans, the employee will only be entitled to the second half of the commission payment if the employee is still employed by the entity when the commission is due. For such plans, an entity needs to carefully evaluate whether the requirement to remain employed in order to receive the commission (i.e., the service vesting condition) is substantive.

Frequently asked questions (cont'd)

We believe that the second half of the commission payment would not be incremental if the service condition is substantive because other conditions are necessary, beyond simply obtaining the contract, for the entity to incur the cost.

If the entity's payment of a commission is only 'contingent' on a customer paying the amount due in the obtained contract, we do not believe this would influence the determination of whether the commission is an incremental cost, provided the contract meets the Step 1 criteria to be accounted for as a contract under the five-step model. However, if there is an extended payment term (i.e., there is a significant amount of time between contract signing and the date in which the contract consideration is due), the entity should consider whether there is a service condition or other contingency, as discussed above.

Question 9-7: Should commission payments subject to a threshold be considered incremental costs? [FASB TRG meeting 7 November 2016 - Agenda paper no. 57]

Yes. FASB TRG members generally agreed that basing a commission on a pool of contracts, rather than paying a set percentage for each contract, would not affect the determination of whether the commissions would have been incurred if the entity did not obtain the contracts with those customers. Consider the following example in a TRG agenda paper:

Example of commission payments subject to a threshold

An entity has a commission programme that increases the amount of commission a salesperson receives based on how many contracts the salesperson has obtained during an annual period, as follows:

0-9 contracts	0% commission
10-19 contracts	2% of value of contracts 1-19
20+ contracts	5% of value of contracts 1-20+

FASB TRG members generally agreed that these costs are incremental costs of obtaining a contract with a customer. Therefore, the costs should be capitalised when the entity incurs a liability to pay these commissions. The costs are incremental because the entity will pay the commission under the programme terms as a result of entering into the contracts. See Question 9-22 for discussion about the period over which an entity would amortise a sales commission that is subject to a threshold and is considered an incremental cost of obtaining a contract.

Question 9-8: Would an entity capitalise commissions paid on contract modifications? [TRG meeting 26 January 2015 – Agenda paper no. 23]

Yes, if they are incremental (i.e., they would not have been incurred if there had not been a modification) and recoverable. Contract modifications are accounted for in one of three ways: (1) as a separate contract; (2) as a termination of the existing contract and the creation of a new contract; or (3) as part of the existing contract (see section 3.4 for further requirements on contract modifications). In all three cases, commissions paid on contract modifications are incremental costs of obtaining a contract and should be capitalised if they are recoverable. In the first two cases, a new contract is created, so the costs of obtaining that contract would be incremental.

Frequently asked questions (cont'd)

The TRG agenda paper said that commissions paid on the modification of a contract that is accounted for as part of the existing contract are incremental costs even though they are not initial incremental costs.

Question 9-9: Would fringe benefits on commission payments be included in the capitalised amounts? [TRG meeting 26 January 2015 – Agenda paper no. 23]

Fringe benefits should be capitalised as part of the incremental cost of obtaining a contract if the additional costs are based on the amount of commissions paid and the commissions qualify as costs to obtain a contract. However, if the costs of fringe benefits would have been incurred regardless of whether the contract had been obtained (e.g., health insurance premiums), the fringe benefits should not be capitalised. That is, an entity cannot allocate fringe benefits to the commission and, therefore, capitalise a portion of the costs of benefits it would provide regardless of whether the commission was paid.

Question 9-10: Must an entity apply the practical expedient to expense contract acquisition costs to all of its qualifying contracts across the entity or can it apply the practical expedient to individual contracts?

We believe the practical expedient to expense contract acquisition costs (that would, otherwise, be amortised over a period of one year or less) must be applied consistently to contracts with similar characteristics and in similar circumstances.

Question 9-11: How would an entity account for capitalised commissions upon a modification of the contract that is treated as the termination of an existing contract and the creation of a new contract?

We believe an asset recognised for incremental costs to obtain a contract that exists when the related contract is modified should be carried forward into the new contract, if the modification is treated as the termination of an existing contract and the creation of a new contract and the goods or services to which the original contract cost asset relates are part of the new contract. This is because the contract cost asset relates to goods or services that have not yet been transferred and the accounting for the modification is prospective. This conclusion is similar to the one reached by FASB TRG members in relation to the accounting for contract assets upon a contract modification, as discussed in Question 10-5 in section 10.1.

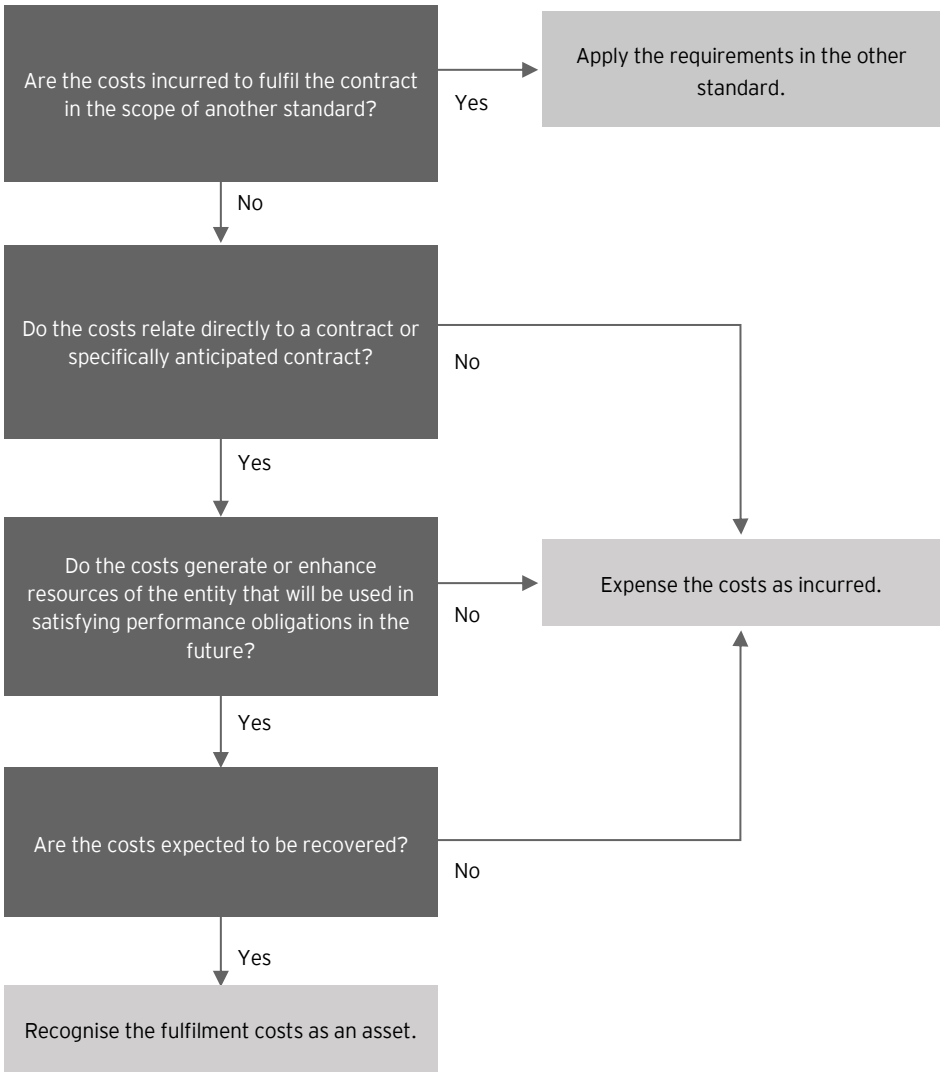
The contract cost asset that remains on the entity's statement of financial position at the date of modification would continue to be evaluated for impairment in accordance with IFRS 15 (see section 9.3.4). In addition, an entity should determine an appropriate amortisation period for the contract cost asset (see section 9.3.3).

9.3.2 Costs to fulfil a contract (updated October 2020)

The standard divides contract fulfilment costs into two categories: (1) costs that give rise to an asset; and (2) costs that are expensed as incurred. When determining the appropriate accounting treatment for such costs, IFRS 15 makes it clear that any other applicable standards are considered first. If those other standards preclude capitalisation of a particular cost, then an asset cannot be recognised under IFRS 15.[380] If other standards are not applicable to contract fulfilment costs, IFRS 15 provides the following criteria for capitalisation:

- The costs directly relate to a contract or to a specifically identifiable anticipated contract (e.g., costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved).
- The costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future.
- The costs are expected to be recovered.[381]

If all of the criteria are met, an entity is required to capitalise the costs. The following flow chart illustrates these requirements:



[380] IFRS 15.BC307.
[381] IFRS 15.95.

Standards that may be applicable to costs to fulfil a contract with a customer include, but are not limited to, the following:

- Inventory costs within the scope of IAS 2
- Costs related to the acquisition of an intangible asset within the scope of IAS 38
- Costs attributable to the acquisition or construction of property, plant and equipment within the scope of IAS 16 or an investment property within the scope of IAS 40
- Costs related to biological assets or agricultural produce within the scope of IAS 41 *Agriculture* or bearer plants within the scope of IAS 16

Example 37 in the standard (included below) illustrates some costs that are accounted for under other standards.

The IFRS IC received a request about the recognition of training costs incurred to fulfil a contract with a customer in relation to an entity that supplies outsourced services and incurs costs to train its employees so that they understand the customer's equipment and processes. In March 2020, the Committee concluded that, before assessing the criteria in IFRS 15.95, an entity first considers whether the training costs incurred to fulfil the contract are within the scope of another IFRS standard. In relation to the request, since IAS 38 explicitly includes expenditure on training within its scope, the entity would apply the IAS 38 requirements and not IFRS 15. IAS 38 requires an entity to expense training costs as incurred and states that "an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset".[382] The Committee noted that the Basis for Conclusions on IFRS 15 states that "if the other Standards preclude the recognition of any asset arising from a particular cost, an asset cannot then be recognised under IFRS 15".[383] Therefore, since IAS 38 requires those costs to be expensed as incurred, they cannot be capitalised under IFRS 15. The Committee concluded that IFRS 15 and IAS 38 provide an adequate basis for an entity to determine its accounting for training costs incurred to fulfil a contract with a customer and decided not to add the matter to its agenda.

When determining whether costs meet the criteria for capitalisation in IFRS 15, an entity must consider its specific facts and circumstances.

With regard to the first criterion, IFRS 15 states that costs can be capitalised even if the contract with the customer is not yet finalised. However, rather than allowing costs to be related to any potential future contract, the standard requires that the costs relate directly to a specifically anticipated contract.

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[382] IAS 38.15, 68-69.
[383] IFRS 15.BC307.
[384] IFRS IC Agenda paper 2, September 2019, *Training Costs to Fulfil a Contract (IFRS 15)*, available on the IASB's website; and *IFRIC Update* March 2020, available on the IASB's website.

The standard provides examples of costs that may meet the first criterion for capitalisation (i.e., costs that relate directly to the contract or a specifically anticipated contract) as follows:

Extract from IFRS 15

97. Costs that relate directly to a contract (or a specific anticipated contract) include any of the following:

(a) direct labour (for example, salaries and wages of employees who provide the promised services directly to the customer);

(b) direct materials (for example, supplies used in providing the promised services to a customer);

(c) allocations of costs that relate directly to the contract or to contract activities (for example, costs of contract management and supervision, insurance and depreciation of tools, equipment and right-of-use assets used in fulfilling the contract);

(d) costs that are explicitly chargeable to the customer under the contract; and

(e) other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors).

Significant judgement may be required to determine whether costs meet the second criterion for capitalisation (i.e., the costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future). In the Basis for Conclusions, the IASB explained that the standard only results in the capitalisation of costs that meet the definition of an asset and precludes an entity from deferring costs merely to normalise profit margins throughout a contract (by allocating revenue and costs evenly over the contract term).[385]

For costs to meet the third criterion (i.e., the 'expected to be recovered' criterion), they need to be either explicitly reimbursable under the contract or reflected through the pricing on the contract and recoverable through margin. Determining whether the costs are expected to be recovered may be challenging and require significant judgement if some, or all, of the transaction price is contingent (e.g., success-based fees).

[385] IFRS 15.BC308.

If the criteria are not met, the costs incurred in fulfilling a contract do not give rise to an asset and must be expensed as incurred. The standard provides some common examples of costs that must be expensed as incurred, as follows:

Extract from IFRS 15

98. An entity shall recognise the following costs as expenses when incurred:

(a) general and administrative costs (unless those costs are explicitly chargeable to the customer under the contract, in which case an entity shall evaluate those costs in accordance with paragraph 97);

(b) costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the price of the contract;

(c) costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (ie costs that relate to past performance); and

(d) costs for which an entity cannot distinguish whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations (or partially satisfied performance obligations).

IFRS 15.98(c) specifies that, if a performance obligation (or a portion of a performance obligation that is satisfied over time) has been satisfied, fulfilment costs related to that performance obligation (or portion thereof) can no longer be capitalised. This is true even if the associated revenue has not yet been recognised (e.g., the contract consideration is variable and has been fully or partially constrained). Once an entity has begun satisfying a performance obligation that is satisfied over time, it only capitalises fulfilment costs that relate to future performance. Accordingly, it may be challenging for an entity to capitalise costs that are related to a performance obligation that an entity has already started to satisfy. Similarly, IFRS 15.98(d) specifies that, if an entity is unable to determine whether certain costs relate to past or future performance and the costs are not eligible for capitalisation under other IFRSs, the costs are expensed as incurred.

The IFRS IC received a request about the recognition of costs incurred to fulfil a contract in relation to a performance obligation that is satisfied over time. In June 2019, the Committee concluded that IFRS 15 provides an adequate basis for an entity to determine how to recognise the costs in the fact pattern and decided not to add the matter to its agenda.[386]

[386] *IFRIC Update*, June 2019, available on the IASB's website.

The IFRS IC discussed this issue using the following example.[387]

Example of costs to fulfil a contract related to past performance

An entity enters into a contract with a customer to construct a building. It identifies a single performance obligation, being the promise to transfer the building to the customer, which it expects will take three years to complete. The entity satisfies this performance obligation (and recognises revenue) over time in accordance with IFRS 15.35(c) because the its performance does not create an asset with alternative use and it has an enforceable right to payment (see section 7.1.3).

At the end of the reporting period, the entity has begun constructing the building and has incurred costs related to laying the foundation of the building.

The IFRS IC noted that the foundation costs relate to construction work done on the partly-constructed building, which has been transferred to the customer. Therefore, the costs relate to the entity's past performance in partially satisfying its performance obligation and in accordance with IFRS 15.98(c), should be expensed as incurred. That is, the costs do not meet the criteria to be recognised as an asset under IFRS 15.95.

The standard provides the following example that illustrates costs that are capitalised under other IFRSs, costs that meet the capitalisation criteria and costs that do not:

Extract from IFRS 15

Example 37 — Costs that give rise to an asset (IFRS 15.IE192-IE196)

An entity enters into a service contract to manage a customer's information technology data centre for five years. The contract is renewable for subsequent one-year periods. The average customer term is seven years. The entity pays an employee a CU10,000 sales commission upon the customer signing the contract. Before providing the services, the entity designs and builds a technology platform for the entity's internal use that interfaces with the customer's systems. That platform is not transferred to the customer, but will be used to deliver services to the customer.

Incremental costs of obtaining a contract

In accordance with paragraph 91 of IFRS 15, the entity recognises an asset for the CU10,000 incremental costs of obtaining the contract for the sales commission because the entity expects to recover those costs through future fees for the services to be provided. The entity amortises the asset over seven years in accordance with paragraph 99 of IFRS 15, because the asset relates to the services transferred to the customer during the contract term of five years and the entity anticipates that the contract will be renewed for two subsequent one-year periods.

Costs to fulfil a contract

The initial costs incurred to set up the technology platform are as follows:

	CU
Design services	40,000
Hardware	120,000
Software	90,000
Migration and testing of data centre	100,000
Total costs	350,000

[387] IFRS IC Agenda paper 2, March 2019, *Costs to Fulfil a Contract (IFRS 15)*, available on the IASB's website; and *IFRIC Update* June 2019, available on the IASB's website.

Extract from IFRS 15 (cont'd)

The initial setup costs relate primarily to activities to fulfil the contract but do not transfer goods or services to the customer. The entity accounts for the initial setup costs as follows:

(a) hardware costs—accounted for in accordance with IAS 16 *Property, Plant and Equipment*.

(b) software costs—accounted for in accordance with IAS 38 *Intangible Assets*.

(c) costs of the design, migration and testing of the data centre—assessed in accordance with paragraph 95 of IFRS 15 to determine whether an asset can be recognised for the costs to fulfil the contract. Any resulting asset would be amortised on a systematic basis over the seven-year period (ie the five-year contract term and two anticipated one-year renewal periods) that the entity expects to provide services related to the data centre.

In addition to the initial costs to set up the technology platform, the entity also assigns two employees who are primarily responsible for providing the service to the customer. Although the costs for these two employees are incurred as part of providing the service to the customer, the entity concludes that the costs do not generate or enhance resources of the entity (see paragraph 95(b) of IFRS 15). Therefore, the costs do not meet the criteria in paragraph 95 of IFRS 15 and cannot be recognised as an asset using IFRS 15. In accordance with paragraph 98, the entity recognises the payroll expense for these two employees when incurred.

Frequently asked questions

Question 9-12: Can an entity defer costs of a transferred good or service that would otherwise generate an upfront loss because variable consideration is fully or partially constrained?

An entity should not defer the costs of a transferred good or service when the application of the constraint on variable consideration results in an upfront loss, even if the entity ultimately expects to recognise a profit on that good or service, unless other specific requirements allow or require a deferral of those costs. The criteria in IFRS 15 must be met to capitalise costs to fulfil a contract, including the criterion that the costs must generate or enhance resources of the entity that will be used in satisfying performance obligations in the future. An entity recognises such costs when control of a good or service transfers to the customer. As such, the cost of those sales would not generate or enhance resources of the entity used to satisfy future performance obligations.

Consider the following example: An entity sells goods with a cost of CU500,000 for consideration of CU600,000. The goods have a high risk of obsolescence, which may require the entity to provide price concessions in the future, resulting in variable consideration (see section 5.2.1.A). The entity constrains the transaction price and concludes that it is highly probable that CU470,000 will not result in a significant revenue reversal, even though the entity reasonably expects the contract to ultimately be profitable. When control transfers, the entity recognises revenue of CU470,000 and costs of CU500,000. It would not capitalise the loss of CU30,000 because the loss does not generate or enhance resources of the entity that will be used in satisfying performance obligations in the future.

Frequently asked questions (cont'd)

Question 9-13: How should an entity account for fulfilment costs incurred prior to the contract establishment date that are outside the scope of another standard (e.g., IAS 2)? [TRG meeting 30 March 2015 – Agenda paper no. 33]

Entities sometimes begin activities on a specifically anticipated contract before the contract establishment date (e.g., before agreeing to the contract with the customer, before the contract satisfies the criteria to be accounted for under IFRS 15) that are not within the scope of another standard (e.g., IAS 2). TRG members generally agreed that costs in respect of pre-contract establishment date activities that relate to a good or service that will transfer to the customer at or after the contract establishment date may be capitalised as costs to fulfil a specifically anticipated contract. However, TRG members noted that such costs would still need to meet the criteria in IFRS 15.95 to be capitalised (e.g., they are expected to be recovered under the anticipated contract). Certain costs, such as general and administrative costs that are not explicitly chargeable to the customer under the contract, would not satisfy these criteria and would need to be expensed as incurred.

Subsequent to capitalisation, costs that relate to goods or services that are transferred to the customer at the contract establishment date would be expensed immediately. Any remaining capitalised contract costs would be amortised over the period that the related goods or services are transferred to the customer.

For requirements on recognising revenue for a performance obligation satisfied over time when activities are completed before the contract establishment date, see Question 7-18 in section 7.1.4.C.

Question 9-14: How are the effects of learning curve costs addressed in IFRS 15?

As discussed in the Basis for Conclusions on IFRS 15, "a 'learning curve' is the effect of efficiencies realised over time when an entity's costs of performing a task (or producing a unit) decline in relation to how many times the entity performs that task (or produces that unit)".[388] Learning curve costs usually consist of materials, labour, overhead, rework or other costs that must be incurred to complete the contract (but do not include research and development costs). These types of efficiencies generally can be predicted at inception of an arrangement and are often considered in the pricing of a contract between an entity and a customer.

The IASB noted that in situations where learning curve costs are incurred in relation to a contract with a customer accounted for as a single performance obligation that is satisfied over time to deliver a specified number of units, IFRS 15 requires an entity to select a method of progress that depicts the transfer over time of the good or service to the customer (see section 7.1.4).[389] The IASB further noted that an entity would probably select a method (such as a costs incurred measure of progress) for these types of contracts, which would result in the entity recognising more revenue and expense at the beginning of the contract relative to the end. The IASB clarified that this would be appropriate as an entity would charge a higher

[388] IFRS 15.BC312.
[389] IFRS 15.BC313.

Frequently asked questions (cont'd)

price to a customer only purchasing one unit (rather than multiple units) in order to recover its learning curve costs.

Conversely, when learning curve costs are incurred for a performance obligation satisfied at a point in time (rather than over time), an entity needs to assess whether those costs are within the scope of another standard. The IASB noted that in situations in which an entity incurs cost to fulfil a contract without also satisfying a performance obligation over time, the entity is probably creating an asset that is within the scope of another standard (e.g., IAS 2).[390] For example, if within the scope of IAS 2, the costs of producing the components would accumulate as inventory in accordance with the requirements in IAS 2. The entity would then recognise revenue when control of the inventory transfers to the customer. In that situation, no learning curve costs would be capitalised under IFRS 15 as the costs would be in the scope of another standard.

If the learning curve costs are not within the scope of another standard, we believe they generally will not be eligible for capitalisation under IFRS 15 (e.g., because the costs relate to past (and not future) performance).

Question 9-15: How should an entity account for pre-contract or setup costs?

Pre-contract costs are often incurred in anticipation of a contract and will result in no future benefit unless the contract is obtained. Examples include: (1) engineering, design or other activities performed on the basis of commitments, or other indications of interest, by a customer; (2) costs for production equipment and materials relating to specifically anticipated contracts (e.g., costs for the purchase of production equipment, materials or supplies); and (3) costs incurred to acquire or produce goods in excess of contractual requirements in anticipation of subsequent orders for the same item.

Pre-contract costs that are incurred in anticipation of a specific contract should first be evaluated for capitalisation under other standards (e.g., IAS 2, IAS 16, IAS 38). For example, pre-contract costs incurred to acquire or produce goods in excess of contractual requirements for an existing contract in anticipation of subsequent orders for the same item would likely be evaluated under IAS 2. Some other examples include costs incurred to move newly acquired equipment to its intended location, which could be required to be capitalised under IAS 16 (see Question 9-16), and employee training costs that are expensed in accordance with IAS 38.[391]Pre-contract costs incurred in anticipation of a specific contract that are not addressed under other standards are capitalised under IFRS 15 only if they meet all of the criteria of a cost incurred to fulfil a contract. Pre-contract costs that do not meet the criteria under IFRS 15 are expensed as incurred.

[390] IFRS 15.BC315.

[391] IFRS IC Agenda paper 2, September 2019, *Training Costs to Fulfil a Contract (IFRS 15)*, available on the IASB's website; and *IFRIC Update* March 2020, available on the IASB's website.

Frequently asked questions (cont'd)

Question 9-16: Can mobilisation costs be capitalised as costs to fulfil a contract with a customer under IFRS 15?

Entities incur mobilisation costs when moving personnel, equipment and supplies to a project site either before, at or after inception of a contract with a customer. They are incurred in order to ensure that the entity is in a position to fulfil its promise(s) in a contract (or specifically anticipated contract) with a customer, rather than transferring a good or service to a customer (i.e., they are not a promised good or service).

The assessment of whether mobilisation costs can be capitalised depends on the specific facts and circumstances and may require significant judgement. Entities need to ensure that the costs are: (1) within the scope of IFRS 15; and (2) meet all of the criteria in IFRS 15.95 to be capitalised.

Are the costs within the scope of IFRS 15?

If the asset being moved (e.g., equipment in the scope of IAS 16, inventory in the scope of IAS 2) is in the scope of another standard, an entity should determine whether the mobilisation costs are specifically addressed by the other standard; if so, the cost is outside the scope of IFRS 15.

If the mobilisation costs are not specifically addressed in another standard, or it is not clear whether these are within the scope of another standard, an entity further analyses whether the mobilisation costs are:

- Specific to the asset being moved or applicable to more than one customer under unrelated contracts; in the latter case it is likely that they would not be within the scope of IFRS 15. For example, moving an asset between different premises of the entity to better utilise the asset in preparation for future contracts with many customers;

Or

- Specific to the contract with the customer, in which case, it would be within the scope of IFRS 15. For example, moving an asset to a remote location at the customer's request, which does not provide a benefit to the entity beyond ensuring it is in a position to fulfil its obligation(s) to the customer under the contract.

Do the costs meet the criteria in IFRS 15.95 to be capitalised?

As discussed above, IFRS 15 includes three criteria that must be met for costs to fulfil a contract within its scope can be capitalised:

(a) Entities may need to use judgement to determine if costs relate directly to a contract (or a specifically anticipated contract) as required in IFRS 15.95(a). Indicators that a cost, by function rather than by nature, may be directly related include, but are not limited to, the following:
    - The costs are explicitly or implicitly chargeable to the customer under the contract.
    - The costs are incurred only because the entity entered into the contract.
    - The contract explicitly or implicitly refers to mobilisation activities (e.g., that the entity must move equipment to a specific location).

Frequently asked questions (cont'd)

- The location in which the entity must perform is explicitly or implicitly specified in the contract and the mobilisation costs are incurred in order for the entity to fulfil its promise(s) to the customer.

(b) Significant judgement may also be required to determine whether costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future as required by IFRS 15.95(b). This determination would include (but not be limited to) considering whether:

- The costs are incurred in order for the entity to be able to fulfil the contract

And

- Location is implicitly or explicitly an attribute of the contract.

If a performance obligation (or a portion of a performance obligation that is satisfied over time) has been satisfied, fulfilment costs related to that performance obligation (or portion thereof) can no longer be capitalised (see section 9.3.2 for further discussion).

(c) For costs to meet the 'expected to be recovered' criterion as required by IFRS 15.95(c), they need to be either explicitly reimbursable under the contract or reflected through the pricing on the contract and recoverable through margin.

Question 9-17: Can an entity defer losses incurred on a contract by capitalising related fulfilment costs when it is expected to generate future profits on the sale of optional goods or services (i.e., loss leader)?

No. Certain contracts may be executed as part of a loss leader strategy in which a good is sold at a loss with an expectation that future sales contracts will result in higher sales and/or profits. In determining whether these anticipated contracts should be part of the accounting for the existing loss leader contract, entities need to refer to the definition of a contract in IFRS 15, which is based on enforceable rights and obligations in the existing contract (see section 3.1). While it may be probable that the customer will enter into a future contract or the customer may even be economically compelled, or compelled by regulation to do so, it would not be appropriate to account for an anticipated contract when there is an absence of enforceable rights and obligations.

In addition, if the fulfilment costs incurred during satisfying the initial contract are within the scope of other accounting standards (e.g., IAS 2), the entity must account for those costs under that relevant standard. Even if the costs are not within the scope of another standard, the costs would relate to a satisfied or partially satisfied performance obligation (i.e., the original contract priced at a loss) and, therefore, must be expensed as incurred. IFRS 15 does not permit an entity to defer fulfilment costs or losses incurred based on the expectation of profits in a future contract.

Frequently asked questions (cont'd)

Question 9-18: How should an entity account for costs associated with installation or implementation services?

Entities that provide installation or implementation services to customers incur costs to fulfil the services. To determine the appropriate accounting for these costs, entities first need to determine whether the costs are within the scope of another IFRS (e.g., property, plant and equipment, intangibles).

If they are not within the scope of another IFRS, entities need to determine whether the installation or implementation service is a separate performance obligation that is satisfied over time (see section 4). If it is a performance obligation, then entities generally expense the costs associated with it as incurred because, as discussed in section 9.3.2, it may be challenging to conclude that the costs relate only to the entity's satisfaction of performance obligations in the future, which is required for capitalisation by IFRS 15.95(b).

If the installation or implementation service is not a separate performance obligation, an entity needs to evaluate whether it is required to capitalise the costs to fulfil the contract under the IFRS 15 requirements mentioned above. That is, costs incurred to fulfil a contract are required to be capitalised only if they meet all of the criteria for capitalisation in IFRS 15.95.

The illustrations below contrast an example of implementation services that are determined to be a separate performance obligation (and, therefore, are not capitalised as costs to fulfil a contract) with an example of implementation services that meet the criteria for capitalisation as costs to fulfil a contract under IFRS 15.

Illustration 9-4 — Implementation services are not capitalised costs to fulfil a contract

Technology entity M enters into a three-year SaaS contract with a customer for CU4,000,000 for a subscription to an inventory management application beginning 1 June 20X3. The contract includes implementation services that will be performed at the beginning of the contract, starting on 1 June 20X3. The implementation services include data migration, creation of objects for the customer's products that will be inventoried, and customisation of the application's layout with the customer's logo and colour scheme. Several third-party service providers also sell implementation services for Technology entity M's application. Assume that the implementation services do not represent a significant integration service (i.e., the implementation services do not significantly modify or customise the SaaS) and the SaaS is fully functional without the implementation service. Under the contract, the customer receives access to the fully functional SaaS on 1 June 20X3.

Technology entity M determines that the costs incurred related to the implementation services are not within the scope of another IFRS (e.g., property, plant and equipment, intangibles).

Technology entity M then considers the implementation services and SaaS and determines that they are separate performance obligations that will be satisfied over time. This is because the implementation services and SaaS can be purchased separately. Technology entity M determines that it is able to fulfil its promise to transfer the SaaS separately from the implementation services, indicating that the two are not highly interdependent or interrelated. Therefore, Technology entity M determines

Frequently asked questions (cont'd)

Illustration 9-5 — Implementation services are capitalised costs to fulfil a contract

that the costs incurred related to implementation services do not meet the criteria for capitalisation because they do not relate to the entity's satisfaction of performance obligations in the future (i.e., the costs are incurred as the performance obligation for implementation services is satisfied).

Technology entity N enters into a contract with a customer for CU2,000,000 for a one-year SaaS subscription to an enterprise software application beginning when the customer obtains access to the SaaS. The contract includes implementation services that will be performed at the beginning of the contract, starting on 1 January 20X5. The implementation services, which will take approximately two months to complete, must be performed in order for the customer to access the SaaS because the services involve the creation of customer-specific interfaces. Technology entity N does not sell the SaaS without these implementation services and no other vendors are able to perform the implementation services because they require the creation of code that will reside on Technology entity N's servers.

Technology entity N determines that the costs incurred related to the implementation services are not within the scope of another IFRS (e.g., property, plant and equipment, intangibles) .

Technology entity N then determines that the implementation services are not capable of being distinct. This is because they cannot be purchased separately or provided by a third party and because the services do not provide benefit on their own or with other readily available resources (since the SaaS has not yet been provided and also cannot be sold separately). Therefore, the implementation services and SaaS subscription are a combined performance obligation.

Technology entity N also concludes that the combined performance obligation meets the requirements for recognition over time. It determines that revenue will be recognised over the contract term, beginning when the customer obtains access to the SaaS.

Therefore, Technology entity N considers whether the costs incurred related to the implementation services that will be provided at the outset of the contract (i.e. before the customer obtains access to the SaaS) meet the criteria to be capitalised as a cost to fulfil the contract, as follows:

- The costs relate specifically to the SaaS contract with this customer
- The costs generate a resource (the interfaces) that will be used to provide the SaaS, the future performance obligation, to the customer
- The costs are expected to be recovered based on the margin included in the contract

As such, Technology entity N determines that the costs should be capitalised as a cost to fulfil as the implementation services are performed. The costs will then be amortised over the estimated period of benefit beginning when the customer gains access to the SaaS.

9.3.3 Amortisation of capitalised contract costs (updated October 2020)

Any capitalised contract costs are amortised, with the expense recognised on a systematic basis that is consistent with the entity's transfer of the related goods or services to the customer.

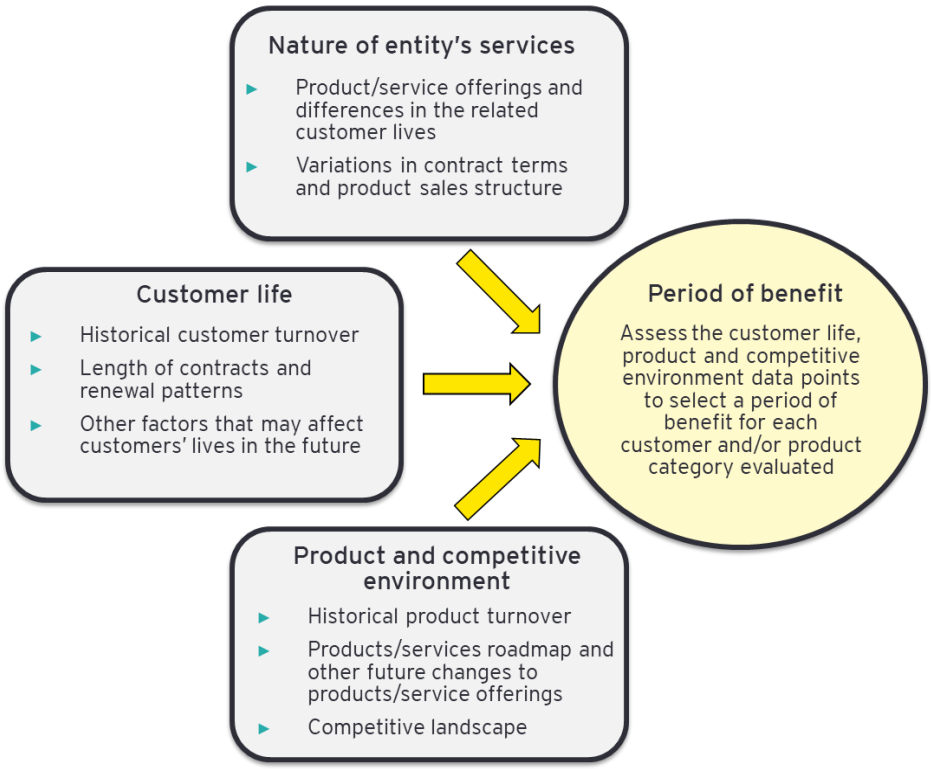
IFRS 15.99 states that capitalised contract costs are amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates. When the timing of revenue recognition (e.g., at a point in time, over time) aligns with the transfer of the goods or services to the customer, the amortisation of the capitalised contract costs in a reporting period will correspond with the revenue recognition in that reporting period. However, the timing of revenue recognition may not always align with the transfer of the goods and services to the customer (e.g., when variable consideration is constrained at the time the related performance obligation is satisfied). When this occurs, the amortisation of the capitalised contract costs will not correspond with the revenue recognition in a reporting period.

For example, consider an entity that enters into a contract with a customer with two performance obligations: (a) a right-to-use licence; and (b) a related service for three years. Further assume that payment from the customer is based on the customer's usage of the intellectual property (i.e., a usage-based royalty). Revenue in respect of the licence of intellectual property would be recognised at a point in time (see section 8.3.2) and revenue in respect of the related service would be recognised over time. The transaction price allocated to the performance obligation for the licence of intellectual property cannot be recognised at the point in time when control of the licence transfers to the customer due to the royalty recognition constraint (see section 8.5). Accordingly, any capitalised contract costs that relate to the licence need to be fully amortised upon the transfer of control of that licence (i.e., at a point in time), regardless of when the related revenue will be recognised. Any capitalised contract costs that relate to the services need to be amortised over the period of time consistent with the transfer of control of the service.

It is important to note that capitalised contract costs may relate to multiple goods or services (e.g., design costs to manufacture multiple distinct goods when design services are not a separate performance obligation) in a single contract. In such instances, the amortisation period could be the entire contract term. See Question 9-21 for a discussion on how an entity might determine the appropriate amortisation period when capitalised contract costs relate to multiple performance obligations. The amortisation period could also extend beyond a single contract, if the capitalised contract costs relate to goods or services being transferred under multiple contracts or to a specifically anticipated contract (e.g., certain contract renewals).

In these situations, the capitalised contract costs would be amortised over a period that is consistent with the transfer to the customer of the goods or services to which the asset relates. This can also be thought of as the expected period of benefit of the asset capitalised. The expected period of benefit may be the expected customer relationship period, but that is not always the case. To determine the appropriate amortisation period, an entity needs to evaluate the type of capitalised contract costs, what the costs relate to and other facts and circumstances of the specific arrangement. Furthermore, before including estimated renewals in the period of benefit, an entity needs to evaluate its history with renewals, to conclude that such an estimate is supportable.

The following graphic lists some factors that should be considered in the evaluation of the period of benefit:



An entity updates the amortisation period when there is a significant change in the expected timing of transfer to the customer of the goods or services to which the asset relates (and accounts for such a change as a change in accounting estimate in accordance with IAS 8), as illustrated in the following example:

Illustration 9-5 — Amortisation period

Entity A enters into a three-year contract with a new customer for transaction processing services. To fulfil the contract, Entity A incurred set-up costs of CU60,000, which it capitalised in accordance with IFRS 15.95-98 and will amortise over the term of the contract.

At the beginning of the third year, the customer renews the contract for an additional two years. Entity A will benefit from the initial set-up costs during the additional two-year period. Therefore, it changes the remaining amortisation period from one year to three years and adjusts the amortisation expense in the period of the change and future periods in accordance with the requirements in IAS 8 for changes in accounting estimates. The disclosure requirements of IAS 8 related to changes in accounting estimates are also applicable.

However, under IFRS 15, if Entity A had been in the position to anticipate the contract renewal at contract inception, Entity A would have amortised the set-up costs over the anticipated term of the contract including the expected renewal (i.e., five years).

Determining the amortisation period for incremental costs of obtaining a contract with a customer can be complicated, especially when contract renewals are expected and the commission rates are not constant throughout the entire life of the contract.

When evaluating whether the amortisation period for a sales commission extends beyond the original contract period, an entity would also evaluate whether an additional commission is paid for subsequent renewals. If so, it evaluates whether the renewal commission is considered 'commensurate' with the original commission. See Question 9-19 below for further discussion on whether a commission is commensurate. In the Basis for Conclusions, the IASB explained that amortising the asset over a longer period than the initial contract would not be appropriate if an entity pays a commission on a contract renewal that is commensurate with the commission paid on the initial contract. In that case, the costs of obtaining the initial contract do not relate to the subsequent contract.[392] An entity would also need to evaluate the appropriate amortisation period for any renewal commissions that are required to be capitalised under IFRS 15 in a similar manner. See Question 9-20 below for the FASB TRG's discussion of how an entity should determine the amortisation period of an asset recognised for the incremental costs of obtaining a contract with a customer.

How we see it

Under IFRS 15, entities are required to evaluate whether the period of benefit is longer than the term of the initial contract. As discussed above, it is likely that an entity would be required to amortise the capitalised sales commission cost over a period longer than the initial contract, if a renewal commission is not paid or a renewal commission is paid that is not commensurate with the original commission.

In determining the appropriate amortisation period or the period of benefit for capitalised contract costs, an entity considers its facts and circumstances and may use judgement similar to that used when estimating the amortisation period for intangible assets (e.g., a customer relationship intangible acquired in a business combination). This could include considering factors such as customer retention and how quickly the entity's products and services change.

It is important for entities to document the judgements they make when determining the appropriate amortisation period and disclose the same in their financial statements. IFRS 15 disclosure requirements (see section 10.5.3) include judgements made in determining the amounts of costs that are capitalised, the amortisation method chosen and other quantitative disclosures.

[392] IFRS 15.BC309.

Frequently asked questions

Question 9-19: How should an entity determine whether a commission on a renewal contract is commensurate with the commission on the initial contract? [FASB TRG meeting 7 November 2016 - Agenda paper no. 57]

FASB TRG members generally agreed that the commissions would have to be reasonably proportional to the contract values (e.g., 5% of both the initial and renewal contract values) to be considered commensurate. FASB TRG members also generally agreed that it would not be reasonable for an entity to use a 'level of effort' analysis to determine whether a commission is commensurate. For example, a 6% commission on an initial contract and a 2% commission on a renewal would not be commensurate even if the declining commission rate corresponds to the level of effort required to obtain the contracts.

As discussed above in section 9.3.3, if the renewal commission is considered to be commensurate with the commission on the initial contract, it would not be appropriate to amortise any asset for the initial commission over a longer period than the initial contract. In contrast, it is likely that it would be appropriate to amortise the asset over a longer period than the initial contract if the commissions are not considered to be commensurate (such as in the example above). See Question 9-20 below for discussion of how an entity determines this longer amortisation period.

Although the TRG did not discuss this, entities would also need to evaluate whether any expected subsequent renewal commissions are commensurate with prior renewal commissions to determine the appropriate amortisation period for any renewal commissions that are required to be capitalised under IFRS 15. Continuing the above example, assume the original three-year contract (for which a 6% commission is paid) and each subsequent renewal contract (for which a 2% renewal commission is paid) is for a one-year term. If the entity expects to renew the contract in years two through four and continue to pay a constant 2% commission upon each renewal, each renewal commission would be considered commensurate. As a result, it is likely that the appropriate amortisation period for each renewal required to be capitalised would be one year. See Question 9-23 below for discussion of when an entity would begin to amortise an asset recognised for the incremental cost of obtaining a renewal contract.

Question 9-20: How should an entity determine the amortisation period of an asset recognised for the incremental costs of obtaining a contract with a customer? [FASB TRG meeting 7 November 2016 - Agenda paper no. 57 and TRG meeting 26 January 2015 - Agenda paper no. 23]

FASB TRG members generally agreed that when an entity determines an amortisation period that is consistent with the transfer to the customer of the goods or services to which the asset relates, it must determine whether the capitalised contract costs relate only to goods or services that will be transferred under the initial contract, or whether the costs also relate to goods or services that will be transferred under a specifically anticipated contract. For example, if an entity only pays a commission based on the initial contract and does not expect the customer to renew the contract (e.g., based on its past experience or other relevant information), amortising the asset over the initial term would be appropriate.

Frequently asked questions (cont'd)

However, if the entity's past experience indicates that the customer is likely to renew the contract, the amortisation period would be longer than the initial term if the renewal commission is not 'commensurate' with the initial commission. See Question 9-19 above for a discussion of commensurate.

FASB TRG members generally agreed that an entity needs to evaluate its facts and circumstances to determine an appropriate amortisation period if it determines that the period should extend beyond the initial contract term, because the commission on the renewal contract is not commensurate with the commission on the initial contract. An entity might reasonably conclude that its average customer life is the best estimate of the amortisation period that is consistent with the transfer of the goods or services to which the asset relates (e.g., if the good or service does not change over time, such as a health club membership). However, FASB TRG members generally agreed that this approach is not required and that entities should not use this as a default. FASB TRG members noted that entities would use judgement that is similar to judgement used when estimating the amortisation period for intangible assets (e.g., a customer relationship intangible acquired in a business combination) and could consider factors such as customer loyalty and how quickly their products and services change.

Consider a technology entity that capitalises a commission earned on the sale of software, which the entity estimates it will maintain and support for only the next five years, and the estimated customer life is seven years. In evaluating the period of benefit, the entity may reasonably conclude the capitalised commission should be amortised over the five-year life of the software to which the commission relates.

However, in a TRG agenda paper, the staff discussed two acceptable methods for amortising capitalised contract costs that relate to both the original contract and the renewals in cases in which the renewal commission is not commensurate with the initial commission:[393]

- The initial capitalised amount is amortised over the period of benefit that includes expected renewals, while amounts capitalised that relate to renewals are amortised over the renewal period.
- The portion of the initial capitalised amount that is commensurate is amortised over the original contract term and the additional amount that is not commensurate is amortised over the period of benefit that includes expected renewals. Capitalised amounts that relate to renewals are amortised over the renewal period.

Both methods are acceptable because they each meet the objective of amortising the costs on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates. However, an entity needs to select one method and apply it consistently in similar circumstances. Other amortisation methods may also be acceptable if they are consistent with the pattern of transfer to the customer of the goods or services to which the asset relates.

[393] TRG Agenda paper no. 23, *Incremental costs of obtaining a contract*, dated 26 January 2015.

Frequently asked questions (cont'd)

The following example illustrates the two methods described in the TRG agenda paper:

Illustration 9-6 — Methods for amortising capitalised contract costs

An entity has a commission plan that pays a 6% commission to a sales representative each time that sales representative obtains a new contract with a customer and a 2% commission each time that customer renews. Based on the entity's assessment of the requirements in IFRS 15 for contract costs, it has concluded that the commissions earned as part of this commission plan are incremental costs to obtain a contract that are required to be capitalised. Furthermore, the entity has determined that the 2% commission paid for renewals is not commensurate with the 6% commission paid for initial contracts and, therefore, the period of benefit for capitalised commissions extends beyond the initial contract term.

The entity performs an assessment of average customer life, technology turnover and competitive factors and concludes that the period of benefit for capitalised commissions is five years.

The entity executes a three-year service contract with a customer for CU600,000 and pays a 6% commission to the sales representative. At the end of the three-year term, the customer renews the contract for two more years for CU400,000 and the entity pays a 2% commission to the sales representative.

The following are two acceptable methods for amortising the capitalised contract costs related to the CU36,000 commission paid on the initial contract and the CU8,000 commission paid on the renewal:

Method 1

The CU36,000 commission related to the initial contract that was capitalised is amortised over the five-year period of benefit. When the contract is renewed, the CU8,000 commission related to the renewal that was capitalised is amortised over the two-year renewal period. The commission would be amortised, as follows:

CU	Year 1	Year 2	Year 3	Year 4	Year 5
Initial commission	7,200	7,200	7,200	7,200	7,200
Renewal commission	–	–	–	4,000	4,000
Total amortisation expense	7,200	7,200	7,200	11,200	11,200

Frequently asked questions (cont'd)

Illustration 9-6 — Methods for amortising capitalised contract costs (cont'd)

Method 2

The CU36,000 commission related to the initial contract that was capitalised is separated into two components: CU12,000 that is commensurate with the commission paid on renewal (i.e., the amount of commission that the CU600,000 initial contract earns at the commensurate rate of 2%); and CU24,000 that is not commensurate. The entity amortises the CU12,000 component over the three-year initial contract term and the CU24,000 component over the five-year period of benefit. When the contract is renewed, the CU8,000 commission related to the renewal that was capitalised is amortised over the two-year renewal period. The commission would be amortised, as follows:

CU	Year 1	Year 2	Year 3	Year 4	Year 5
Initial commission (not commensurate)	4,800	4,800	4,800	4,800	4,800
Initial commission (commensurate)	4,000	4,000	4,000	–	–
Renewal commission	–	–	–	4,000	4,000
Total amortisation expense	8,800	8,800	8,800	8,800	8,800

Question 9-21: Can an entity attribute the capitalised contract costs to the individual performance obligations in the contract to determine the appropriate amortisation period? [TRG meeting 26 January 2015 - Agenda paper no. 23]

Yes. We believe an entity can attribute the capitalised contract costs to individual performance obligations in the contract to determine the appropriate amortisation period, but it is not required to do so. IFRS 15.99 states that the asset recognised is amortised on a systematic basis "that is consistent with the transfer to the customer of the goods or services to which the asset relates". The TRG agenda paper noted that an entity may meet this objective by allocating the capitalised contract costs to performance obligations on a relative basis (i.e., in proportion to the transaction price allocated to each performance obligation) to determine the period of amortisation.

Frequently asked questions (cont'd)

Illustration 9-7 — Allocation of capitalised contract costs

A technology entity executes a contract for CU600,000 for a perpetual software licence and one year of PCS. Based on the stand-alone selling prices, the entity allocates CU500,000 (83%) of the total transaction price to the licence and CU100,000 (17%) to the PCS. The entity pays a 4% commission to the sales representative and has determined that the commission is required to be capitalised under IFRS 15 because it is an incremental cost of obtaining the contract. The entity concludes that the CU24,000 sales commission needs to be allocated between the licence and the PCS and amortised over the expected period of benefit associated with each of those performance obligations. The entity allocates CU20,000 (83%) to the licence and CU4,000 (17%) to the PCS, consistent with the relative value of the performance obligations to the transaction price.

Other methods for allocating capitalised contract costs may be appropriate. For example, we believe an entity may also meet the objective by allocating specific capitalised contract costs to individual performance obligations when the costs relate specifically to certain goods or services. An entity needs to have objective evidence to support a conclusion that a specified amount of the costs relates to a specific performance obligation and consistently apply any methods used for allocating capitalised contract costs to performance obligations.

In addition, as discussed above in Question 9-20, an entity that attributes capitalised contract costs to individual performance obligations needs to consider whether the amortisation period for some or all of the performance obligations should extend beyond the original contract (see 9.3.3 above).

The TRG agenda paper also discussed another potentially acceptable amortisation pattern for capitalised contract costs. This pattern relates to multiple performance obligations that are satisfied over different periods that would not require allocation of the asset to individual performance obligations in the contract. That is, an entity may amortise a single capitalised contract cost using one measure of performance taking into consideration all of the performance obligations in the contract. The TRG paper noted that an entity that uses this method needs to select a measure that best reflects the 'use' of the asset as the goods and services are transferred to the customer. That is, the pattern of amortisation must meet the objective of IFRS 15.99 so that it is consistent with the transfer to the customer of the goods or services to which the asset relates.

Question 9-22: Over what period would an entity amortise a sales commission (that is only paid once a threshold is met) that is determined to be an incremental cost to obtain a contract? [TRG meeting 26 January 2015 – Agenda paper no. 23]

The TRG agenda paper indicated that two of the alternatives discussed might meet the objective of amortising the costs on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates. However, either alternative must be applied consistently to similar circumstances. In one alternative, an entity allocated the capitalised costs to all of the contracts that cumulatively resulted in the threshold being met and amortised the costs over the expected customer relationship period of each of those contracts. In the other alternative, an entity allocated the capitalised costs to the contract that resulted in the threshold being met and

Frequently asked questions (cont'd)

amortised the costs over the expected customer relationship period of that contract. The TRG agenda paper noted that the second alternative may result in a counterintuitive answer if the commission paid upon obtaining the contract that resulted in the threshold being met was large in relation to the transaction price for only that contract. While the first alternative may be easier to apply and result in a more intuitive answer than the second alternative in some situations, the TRG agenda paper noted that either approach is acceptable. The TRG agenda paper did not contemplate all possible alternatives.

Consider the following example in the TRG agenda paper:

Example of amortisation of capitalised commission payments subject to a threshold

An entity has a commission programme that increases the amount of commission a salesperson receives based on how many contracts the salesperson has obtained during an annual period. In this example, the first commission is paid when the first contract is signed. Subsequently, once a cumulative threshold number of contracts is reached, a commission is paid on that threshold contract as a fixed escalating amount, taking into account any commission already paid, as follows:

1 contract	CU3,000 commission
10 contracts	CU5,000 cumulative commission (including CU3,000 already paid)
15 contracts	CU10,000 cumulative commission (including CU5,000 already paid)

Assume 11 new contracts are signed by a specific employee in that period.

As discussed in Question 9-7 in section 9.3.1, FASB TRG members generally agreed that commission payments subject to a threshold are incremental costs of obtaining a contract with a customer and, therefore, the costs should be capitalised when the entity incurs a liability to pay these commissions.

In one acceptable alternative, an entity estimates the total amount of commission that is expected to be paid for the period and capitalises an equal amount as each contract is signed. In this example, because the entity estimates that the employee will sign 11 new contracts during the period, it expects the total amount of commission to be paid will be CU5,000. The entity would capitalise CU455 when each contract is signed (i.e., CU5,000 cumulative commission divided by the 11 contracts). The capitalised amount would be amortised over the expected customer relationship period of each of those contracts. That is, the CU455 capitalised for the first contract would be amortised over the expected customer relationship period of the first contract and the CU455 capitalised for the second contract would be amortised over the expected customer relationship period of the second contract.

Frequently asked questions (cont'd)

Example of amortisation of capitalised commission payments subject to a threshold (cont'd)

In the other acceptable alternative, an entity capitalises CU3,000 in commission costs upon signing the first contract. This amount would be amortised over the expected customer relationship period of that contract (i.e., the first contract). The entity would not capitalise any additional costs upon signing the second contract through to the ninth contract because the next commission 'tier' has not been met. Once the tenth contract is signed, the entity capitalises an additional CU2,000 in commission costs. This amount would be amortised over the expected customer relationship period for that contract (i.e., the tenth contract).

Question 9-23: When should an entity begin to amortise an asset recognised for the incremental cost of obtaining a renewal contract?

As discussed in Question 9-19 above, assets recognised for commensurate renewal commissions paid are amortised over the term of the contract renewal, with the expense recognised as the entity transfers the related goods or services to the customer.

We believe that the amortisation of the renewal commission should not begin earlier than the beginning of the renewal period. Consider the following illustration:

Illustration 9-8 — Amortisation of a capitalised contract costs

On 1 January 2018, an entity enters into a three-year service contract with a customer that ends on 31 December 2020. Upon the customer signing the contract, the entity pays a sales employee a CU50,000 sales commission for obtaining the contract. On 30 September 2020, the entity negotiates a three-year renewal term that will begin on 1 January 2021 and pays the sales employee a renewal commission that is commensurate with the initial sales commission paid. Since the entity does not begin to transfer services under the contract renewal until 1 January 2021, the entity would not begin amortising the asset related to the renewal commission until 1 January 2021.

Question 9-24: How should capitalised contract costs and their amortisation be classified and presented in the statement of financial position and statement of profit and loss and other comprehensive income, respectively?

As discussed above in sections 9.3.1 – 9.3.3, IFRS 15 requires incremental costs of obtaining a contract and certain costs to fulfil a contract to be recognised as an asset and that asset to be amortised on a systematic basis. IFRS 15.128 requires separate disclosure of closing balances and the amount of amortisation and impairment losses recognised during the period (see section 10.5.3). However, the standard is silent on the classification of that asset and the related amortisation.

Under legacy IFRS, IAS 2 included the notion of work in progress (or 'inventory') of a service provider. However, this was consequentially removed from IAS 2 and replaced with the relevant requirements in IFRS 15. Furthermore, while these capitalised contract cost assets are intangible, in

Frequently asked questions (cont'd)

nature, IAS 38 specifically excludes from its scope intangible assets arising from contracts with customers that are recognised in accordance with IFRS 15.[394] In the absence of a standard that specifically deals with classification and presentation of contract costs, management would need to apply the requirements in IAS 8 to select an appropriate accounting policy.[395]

In developing such an accounting policy, we believe that costs to obtain a contract and costs to fulfil a contract need to be considered separately for the purpose of classification and presentation in the financial statements:

- Considering the nature of *costs to obtain a contract* and the lack of guidance in IFRS, we believe an entity may choose to classify and present these costs as either:
  - A separate class of asset (similar in nature to work in progress or 'inventory') in the statement of financial position and its amortisation within cost of goods sold, changes in contract costs or similar.

  Or

  - A separate class of intangible assets in the statement of financial position and its amortisation in the same line item as amortisation of intangible assets within the scope of IAS 38.

  In all cases, an entity needs to consider the aggregation requirements of IAS 1 when determining whether the separate classes of assets may be presented together with other assets.

  In addition, the entity needs to consider the requirements in IAS 7 *Statement of Cash Flows*, in particular IAS 7.16(a), when determining the classification of cash flows arising from costs to obtain a contract (i.e., either as cash flow from operating activities or investing activities).
- In contrast, the nature of *costs to fulfil a contract* is such that they directly impact the entity's performance under the contract. Therefore, costs to fulfil a contract should be classified and presented as a separate class of asset in the statement of financial position and its amortisation within cost of goods sold, changes in contract costs or similar.

We do not believe it would be appropriate to analogise to the requirements for intangible assets in IAS 38. Instead, such costs are consistent in nature to costs incurred in the process of production, as is contemplated in IAS 2. That is, in nature, they are consistent with work in progress, or 'inventory', of a service provider. Therefore, whether costs to fulfil a contract meet the criteria for capitalisation in IFRS 15.95 or are expensed as incurred, we believe that classification and presentation of such costs in the statement of profit and loss and other comprehensive income, and the classification and presentation of related cash flows in the statement of cash flows needs to be consistent.

Capitalised contract costs are subject to impairment assessments (see section 9.3.4). Impairment losses are recognised in profit or loss, but the standard is silent on where to classify and present such amounts within the primary financial statements. We believe it would be appropriate for the classification and presentation of any impairment losses to be consistent with the classification and presentation of the amortisation expense.

[394] IAS 38.3(i).
[395] IAS 8.10-12.

9.3.4 Impairment of capitalised contract costs (updated October 2018)

Capitalised contract costs must be tested for impairment. This is because the costs that give rise to an asset must be recoverable throughout the contract period (or period of benefit, if longer), to meet the criteria for capitalisation.

An impairment exists if the carrying amount of the asset exceeds the amount of consideration the entity expects to receive in exchange for providing the associated goods or services, less the remaining costs that relate directly to providing those goods or services. Impairment losses are recognised in profit or loss. Refer to Question 9-24 for further discussion on classifying and presenting impairment losses within profit or loss.

TRG members generally agreed that an impairment test of capitalised contract costs should include future cash flows associated with contract renewal or extension periods, if the period of benefit of the costs under assessment is expected to extend beyond the present contract.[396] In other words, an entity should consider the total period over which it expects to receive economic benefits relating to the asset, for the purpose of both determining the amortisation period and estimating cash flows to be used in the impairment test. The question was raised because of an inconsistency within IFRS 15. IFRS 15 indicates that costs capitalised under the standard could relate to goods or services to be transferred under 'a specific anticipated contract' (e.g., goods or services to be provided under contract renewals and/or extensions).[397] The standard also indicates that an impairment loss would be recognised when the carrying amount of the asset exceeds the remaining amount of consideration expected to be received (determined by using principles in IFRS 15 for determining the transaction price, see section 5 above).[398] However, the requirements for measuring the transaction price in IFRS 15 indicate that an entity does not anticipate that the contract will be "cancelled, renewed or modified" when determining the transaction price.[399]

In some instances, excluding renewals or extensions would trigger an immediate impairment of a contract asset because the consideration an entity expects to receive would not include anticipated cash flows from contract extensions or renewal periods. However, the entity would have capitalised contract costs on the basis that they would be recovered over the contract extension or renewal periods. When an entity determines the amount it expects to receive (see section 5), the requirements for constraining estimates of variable consideration are not considered. That is, if an entity were required to reduce the estimated transaction price because of the constraint on variable consideration, it would use the unconstrained transaction price for the impairment test. While unconstrained, this amount must be reduced to reflect the customer's credit risk before it is used in the impairment test.

However, before recognising an impairment loss on capitalised contract costs incurred to obtain or fulfil a contract, entities need to consider impairment losses recognised in accordance with other standards (e.g., IAS 36 *Impairment of Assets*). After applying the impairment test to the capitalised contract costs, an entity includes the resulting carrying amounts in the carrying amount of a cash-generating unit for purposes of applying the requirements in IAS 36.

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396 TRG Agenda paper no. 4, *Impairment testing of capitalised contract costs*, dated 18 July 2014.
397 IFRS 15.99.
398 IFRS 15.101(a), 102.
399 IFRS 15.49.

Under IFRS, IAS 36 permits the reversal of some or all of previous impairment losses on assets (other than goodwill) or cash-generating units if the estimates used to determine the assets' recoverable amount have changed.[400] Consistent with IAS 36, IFRS 15 permits reversal of impairment losses when impairment conditions no longer exist or have improved. However, the increased carrying amount of the asset must not exceed the amount that would have been determined (net of amortisation) if no impairment loss had been recognised previously.[401]

FASB differences

Under US GAAP, the reversal of previous impairment losses is prohibited.

Frequently asked questions

Question 9-25: How often should an entity assess its capitalised contract costs for impairment under IFRS 15?

IFRS 15 does not explicitly state how often an entity needs to assess its capitalised contract costs for impairment. We believe an entity needs to assess whether there is any indication that its capitalised contract costs may be impaired at the end of each reporting period. This is consistent with the requirement in IAS 36.9 to assess whether there are indicators that assets within the scope of that standard are impaired. For example, during 2020, the coronavirus pandemic may have affected customers' ability and intent to pay, and/or entities may be more willing to accept partial payment or extend payment terms. Such collectability concerns may indicate that entities need to assess related capitalised costs to obtain or fulfil a contract for impairment.

[400] IAS 36.109-125.
[401] IFRS 15.104.

10. Presentation and disclosure

IFRS 15 provides explicit presentation and disclosure requirements, which are more detailed than under legacy IFRS and increase the volume of required disclosures that entities have to include in their interim and annual financial statements.

While not part of the requirements in IFRS 15, entities also need to provide accounting policy disclosures in accordance with IAS 1.[402] Given the complexity of the requirements in IFRS 15, the policies that apply to revenues and costs within the scope of the standard may require entities to provide tailored and detailed disclosures.

Refer to our publication, *Applying IFRS: Presentation and disclosure requirements of IFRS 15*, for further discussion on the presentation and disclosure requirements and possible formats entities could use to disclose information required by IFRS 15 using real-life and/or illustrative examples.[403]

How we see it

As discussed more fully below, IFRS 15 requires extensive and detailed disclosures in entities' financial statements, particularly annual financial statements.

Entities may have to expend considerable effort when preparing the required disclosures for their interim and annual financial statements. For example, some entities operating in multiple segments with many different product lines may find it challenging to gather the data needed to provide the disclosures. Therefore, it is important for entities to have the appropriate systems, internal controls, policies and procedures in place to collect and disclose the required information.

FASB differences

For US GAAP preparers, the standard provides requirements on presentation and disclosure that apply to both public and non-public entities and provide some relief on disclosure requirements for non-public entities. The FASB's standard defines a public entity as one of the following:

(i) A public business entity, as defined

(ii) A not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market

(iii) An employee benefit plan that files or furnishes financial statements with the SEC

An entity that does not meet any of the criteria above is considered a non-public entity for purposes of the FASB's standard.

IFRS 15 does not differentiate between public and non-public entities. Therefore, an entity that applies IFRS 15 must apply all of its requirements.

[402] IAS 1.117.
[403] Latest version of this publication is available at ey.com/IFRS.

10.1 Presentation requirements for contract assets and contract liabilities (updated October 2020)

The revenue model is based on the notion that a contract asset or contract liability is generated when either party to a contract performs, depending on the relationship between the entity's performance and the customer's payment. The standard requires that an entity present these contract assets or contract liabilities in the statement of financial position, as extracted below:

Extract from IFRS 15

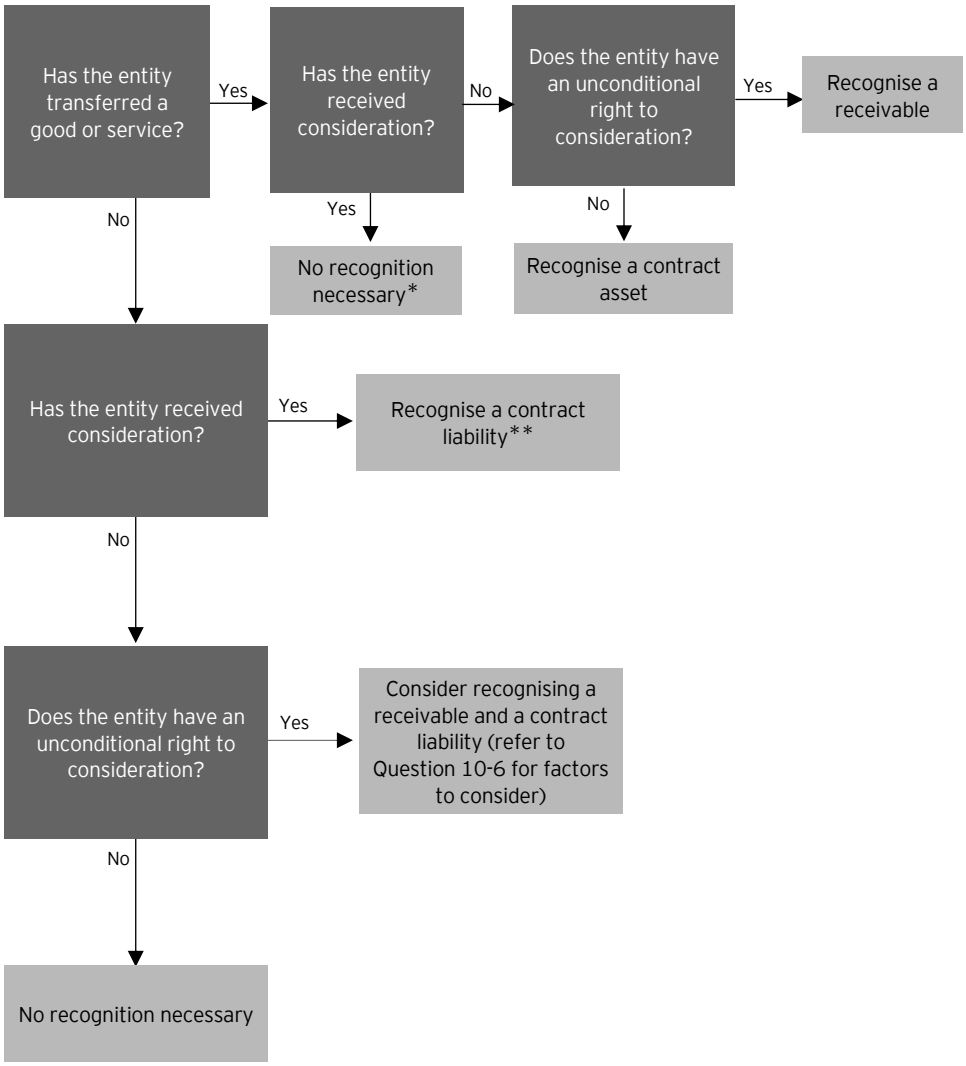
105. When either party to a contract has performed, an entity shall present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.

106. If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (ie a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer.

107. If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a contract asset, excluding any amounts presented as a receivable. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer. An entity shall assess a contract asset for impairment in accordance with IFRS 9. An impairment of a contract asset shall be measured, presented and disclosed on the same basis as a financial asset that is within the scope of IFRS 9 (see also paragraph 113(b)).

108. A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future. An entity shall account for a receivable in accordance with IFRS 9. Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with IFRS 9 and the corresponding amount of revenue recognised shall be presented as an expense (for example, as an impairment loss).

The following flowchart illustrates how an entity determines whether to recognise a receivable, a contract asset or a contract liability on the balance sheet:



*This assumes the consideration received is equal to the amount to which the entity is entitled for the good or service already transferred. If the consideration received is less than this amount, an entity may need to recognise a contract asset or a receivable for the difference. If the consideration received is more than this amount, an entity may need to recognise a contract liability or a refund liability.

**If the customer can cancel the contract and receive a refund of the advance payment, an entity would consider recognising a refund liability (separate from contract liabilities – see Question 10-4).

When an entity satisfies a performance obligation by transferring a promised good or service, the entity has earned a right to consideration from the customer and, therefore, has a contract asset. When the customer performs first, for example, by prepaying its promised consideration, the entity has a contract liability.

An entity could also have recognised other assets related to contracts with a customer (e.g., the incremental costs of obtaining the contract and other costs incurred that meet the criteria for capitalisation). The standard requires that any such assets be presented separately from contract assets and contract liabilities in the statement of financial position or disclosed separately in the

notes to the financial statements (assuming that they are material). These amounts are also assessed for impairment separately (see section 9.3.3).

Distinction between contract assets and receivables

Contract assets may represent conditional or unconditional rights to consideration. The right is conditional, for example, when an entity must first satisfy another performance obligation in the contract before it is entitled to payment from the customer. If an entity has an unconditional right to receive consideration from the customer, the contract asset is accounted for as a receivable and presented separately from other contract assets.[404] A right is unconditional if nothing other than the passage of time is required before payment of that consideration is due.

In the Basis for Conclusions on IFRS 15, the Board explains that in many cases an unconditional right to consideration (i.e., a receivable) arises when an entity satisfies a performance obligation, which could be before it invoices the customer (e.g., an unbilled receivable) if only the passage of time is required before payment of that consideration is due. It is also possible for an entity to have an unconditional right to consideration before it satisfies a performance obligation.[405] In some industries, it is common for an entity to invoice its customers in advance of performance (and satisfaction of the performance obligation). For example, an entity that enters into a non-cancellable contract requiring payment a month before the entity provides the goods or services would recognise a receivable and a contract liability on the date the entity has an unconditional right to the consideration (see Question 10-6 below for factors to consider when assessing whether an entity's right to consideration is considered unconditional). In this situation, revenue is not recognised until goods or services are transferred to the customer.

In December 2015, the IASB discussed application of IFRS 15 to contracts in which the entity has transferred control of a good to the customer at a point in time, but the consideration to which the entity is entitled is contingent upon a market price (e.g., a commodity price), which will be determined at a future date. The example assumed that there was no separable embedded derivative (i.e., the entire contract was within the scope of IFRS 15). In discussing this issue, the Board clarified the nature of conditions that might prevent recognition of a receivable. Specifically, the Board agreed that the variability arising solely from changes in the market price would not be a condition that prevents an entity to recognise a receivable. That is, since the entity has performed, "... nothing else (ie no future event) needs to happen before payment of the consideration is due. The existence of a price in the future requires no event to occur and depends solely on the passage of time. Changes in the price of Commodity do not affect the entity's right to consideration, even though the amount that the entity receives is known only on the payment date. In other words, there is no uncertainty with regards to the entity's **entitlement** to the consideration. The entity's right to consideration is therefore unconditional as understood by IFRS 15...". Therefore, when the entity performs by transferring control of the good to the customer, it recognises a receivable in accordance with IFRS 9 (and is no longer subject to the requirements in IFRS 15 for the variable consideration constraint).[406]

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[404] IFRS 15.BC323-BC324.

[405] IFRS 15.BC325.

[406] IASB meeting, December 2015, Agenda paper no. 7H, *Constraining estimates of variable consideration when the consideration varies based on a future market price*, dated December 2015 and *IASB Update*, December 2015, available on the IASB's website.

In the Basis for Conclusions, the Board noted that making the distinction between a contract asset and a receivable is important because doing so provides users of financial statements with relevant information about the risks associated with the entity's rights in a contract. Although both are subject to credit risk, a contract asset is also subject to other risks (e.g., performance risk).[407]

Under the standard, entities are not required to use the terms 'contract asset' or 'contract liability', but must disclose sufficient information so that users of the financial statements can clearly distinguish between unconditional rights to consideration (receivables) and conditional rights to receive consideration (contract assets).[408]

The standard provides the following example of presentation of contract balances:

Extract from IFRS 15

Example 38 — Contract liability and receivable (IFRS 15.IE198-IE200)

Case A—Cancellable contract

On 1 January 20X9, an entity enters into a cancellable contract to transfer a product to a customer on 31 March 20X9. The contract requires the customer to pay consideration of CU1,000 in advance on 31 January 20X9. The customer pays the consideration on 1 March 20X9. The entity transfers the product on 31 March 20X9. The following journal entries illustrate how the entity accounts for the contract:

(a) The entity receives cash of CU1,000 on 1 March 20X9 (cash is received in advance of performance):

Cash	CU1,000	
Contract liability		CU1,000

(b) The entity satisfies the performance obligation on 31 March 20X9:

Contract liability	CU1,000	
Revenue		CU1,000

Case B—Non-cancellable contract

The same facts as in Case A apply to Case B except that the contract is non-cancellable. The following journal entries illustrate how the entity accounts for the contract:

(a) The amount of consideration is due on 31 January 20X9 (which is when the entity recognises a receivable because it has an unconditional right to consideration):

Receivable	CU1,000	
Contract liability		CU1,000

(b) The entity receives the cash on 1 March 20X9:

Cash	CU1,000	
Receivable		CU1,000

[407] IFRS 15.BC323.
[408] IFRS 15.109.

Extract from IFRS 15 (cont'd)

(c) The entity satisfies the performance obligation on 31 March 20X9:

Contract liability	CU1,000	
Revenue		CU1,000

If the entity issued the invoice before 31 January 20X9 (the due date of the consideration), the entity would not present the receivable and the contract liability on a gross basis in the statement of financial position because the entity does not yet have a right to consideration that is unconditional.

The standard includes another example of presentation of contract balances that illustrates when an entity has satisfied a performance obligation, but does not have an unconditional right to payment and, therefore, recognises a contract asset:

Extract from IFRS 15

Example 39 — Contract asset recognised for the entity's performance (IFRS 15.IE201-IE204)

On 1 January 20X8, an entity enters into a contract to transfer Products A and B to a customer in exchange for CU1,000. The contract requires Product A to be delivered first and states that payment for the delivery of Product A is conditional on the delivery of Product B. In other words, the consideration of CU1,000 is due only after the entity has transferred both Products A and B to the customer. Consequently, the entity does not have a right to consideration that is unconditional (a receivable) until both Products A and B are transferred to the customer.

The entity identifies the promises to transfer Products A and B as performance obligations and allocates CU400 to the performance obligation to transfer Product A and CU600 to the performance obligation to transfer Product B on the basis of their relative stand-alone selling prices. The entity recognises revenue for each respective performance obligation when control of the product transfers to the customer.

The entity satisfies the performance obligation to transfer Product A:

Contract asset	CU400	
Revenue		CU400

The entity satisfies the performance obligation to transfer Product B and to recognise the unconditional right to consideration:

Receivable	CU1,000	
Contract asset		CU400
Revenue		CU600

Also consider the following example, which illustrates an unbilled receivable (rather than a contract asset):

Illustration 10-1 — Unbilled receivable
On 14 September 20X0, Entity L enters into a contract to sell 100 widgets to Customer F at CU10 per widget. All of the widgets are delivered to Customer F on 29 September 20X0. Entity L invoices Customer F on 12 October 20X0. Entity L determines that revenue is recognised when control of the widgets transfers to Customer F on 29 September 20X0. Entity L records a corresponding receivable because only the passage of time is required before payment of that consideration is due. That is, Entity L has an unconditional right to consideration as at 29 September 20X0, even though Entity L has not yet issued an invoice. That is, even though the amount is 'unbilled', it is still considered a receivable, rather than a contract asset.

Current versus non-current

Unless an entity presents its statement of financial position on a liquidity basis, it needs to present contract assets or contract liabilities as current or non-current in the statement of financial position. Since IFRS 15 does not address this classification, entities need to consider the requirements in IAS 1.

The distinction between current and non-current items depends on the length of the entity's operating cycle. IAS 1 states that the operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. However, when the entity's normal operating cycle is not clearly identifiable, it is assumed to be 12 months.[409] IAS 1 does not provide guidance on how to determine whether an entity's operating cycle is 'clearly identifiable'. For some entities, the time involved in producing goods or providing services may vary significantly between contracts with one customer to another. In such cases, it may be difficult to determine what the normal operating cycle is. Therefore, entities need to consider all facts and circumstances and use judgement to determine whether it is appropriate to consider that the operating cycle is clearly identifiable, or whether to use the twelve-month default. This assessment is also relevant for other assets and liabilities arising from contracts with customers within the scope of IFRS 15 (e.g., capitalised contract costs to obtain and fulfil a contract).

Consequently, an entity assesses, based on the contract terms, facts and circumstances, whether a contract asset or contract liability is classified as current or non-current. It considers:

- For a contract asset: when payment is due (e.g., based on payment schedule agreed with client)
- For a contract liability: the timing of satisfaction of the performance obligation as a factor when applying the requirements of IAS 1[410]

This assessment might lead to a separation of the contract asset or contract liability into a current and a non-current portion.

[409] IAS 1.68, 70.
[410] IAS 1.69.

Impairment of contract assets

After initial recognition, contract assets, like receivables, are subject to impairment assessments in accordance with IFRS 9. The Basis for Conclusions on IFRS 9.BC5.154 clarifies that contract assets are in scope of IFRS 9 impairment because the IASB considered "the exposure to credit risk on contract assets is similar to that of trade receivables".[411]

The expected credit loss model in IFRS 9 focuses on the difference between the contractual cash flows and expected cash flows.[412] However, the right to receive non-cash consideration does not give rise to cash inflows. As such, judgement may be needed when the consideration to which the entity is entitled is non-cash. Since the entity does not yet hold the non-cash consideration, the impairment requirements in IAS 36, for example, do not directly apply.

When applying the impairment requirements of IFRS 9 to the contract asset, an entity considers the likelihood of not receiving the non-cash consideration (i.e., non-performance risk). However, this would not consider any potential impairment in the underlying asset to which the entity is entitled. As such, an entity may need to consider the value of the underlying non-cash consideration to which it is entitled to use as a proxy for the cash inflows when applying the impairment requirements of IFRS 9.

As discussed in section 5.5.2 above, impairment losses on receivables are presented in line with the requirements of IAS 1 and the disclosure requirements in IFRS 7 apply.[413] In addition, as discussed at 10.2 below, IFRS 15 requires that such amounts are disclosed separately from impairment losses from other contracts.[414] These requirements also apply to impairment losses on contract assets.

Derecognition of contract assets

Contract assets will generally be derecognised when an entity's right to consideration becomes unconditional, and it is able to recognise a receivable in accordance with IFRS 9. IFRS 15 does not provide any additional requirements on derecognising contract assets and only the impairment requirements in IFRS 9 apply to contract assets. In theory, entities could also apply the derecognition requirements in IFRS 9 by analogy to contract assets. However, in practice, we believe that it is very unlikely that many contract assets would meet the requirements for derecognition in IFRS 9, particularly if they are still conditional on the entity's future performance.

Initial measurement of receivables

IFRS 9 includes different initial measurement requirements for receivables arising from IFRS 15 contracts depending on whether there is a significant financing component.

- If there is a significant financing component, the receivable is initially measured at fair value[415]
- If there is no significant financing component (or the entity has used the practical expedient in IFRS 15.63), the receivable is initially recognised at the transaction price, measured in accordance with IFRS 15[416]

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411 IFRS 9.BC5.154.
412 IFRS 9.B5.5.29.
413 IFRS 7.35A(a).
414 IFRS 15.113(b).
415 IFRS 9.5.1.1.
416 IFRS 9.5.1.3.

If upon initial measurement there is a difference between the measurement of the receivable under IFRS 9 and the corresponding amount of revenue, that difference is presented immediately in profit or loss (e.g., as an impairment loss).

If the initial measurement of a receivable is at fair value, there may be a number of reasons why differences from the IFRS 15 transaction price may arise (e.g., changes in the fair value of non-cash consideration not yet received). This is the case when the difference is attributable to customer credit risk, rather than an implied price concession. Implied price concessions are deducted from the contract price to derive the transaction price, which is the amount recognised as revenue. Distinguishing between implied price concessions and expense due to customer credit risk requires judgement (see section 5.2.1.A). Impairment losses resulting from contracts with customers are presented separately from other impairment losses (see section 10.5.1 for further discussion).[417]

Frequently asked questions

Question 10-1: How would an entity determine the presentation of contract assets and liabilities for contracts that contain multiple performance obligations? [TRG meeting 31 October 2014 – Agenda paper no. 7]

TRG members generally agreed that contract assets and liabilities would be determined at the contract level and not at the performance obligation level. That is, an entity does not separately recognise an asset or liability for each performance obligation within a contract, but aggregates them into a single contract asset or liability.

This question arose in part because, under the standard, the amount and timing of revenue recognition is determined based on progress toward complete satisfaction of *each* performance obligation. Therefore, some constituents questioned whether an entity could have a contract asset and a contract liability for a single contract. An example is when the entity has satisfied (or partially satisfied) one performance obligation in a contract for which consideration is not yet due, but has received a prepayment for another unsatisfied performance obligation in the contract. Members of the TRG generally agreed that the discussion in the Basis for Conclusions was clear that contract asset or contract liability positions are determined for each contract on a net basis. This is because the rights and obligations in a contract with a customer are interdependent – the right to receive consideration from a customer depends on the entity's performance and, similarly, the entity performs only as long as the customer continues to pay. The Board decided that those interdependencies are best reflected by accounting and presenting contract assets or liabilities on a net basis.[418]

[417] IFRS 15.113(b).
[418] IFRS 15.BC317.

Frequently asked questions (cont'd)

Consider the following example:

Illustration 10-2 — Presentation of contract assets and liabilities

Entity A has a contract with Customer B to transfer a licence on 1 January 20X0 for the right to use Entity A's intellectual property in exchange for a CU200,000 milestone payment that is contingent upon Customer B achieving a specific outcome. The contract also includes a one-year service to be provided by Entity A for fixed consideration of CU100,000 that is paid upfront by Customer B at contract inception.

Assume Entity A concludes there are two performance obligations: one for the right to use licence of intellectual property that will be satisfied when the licence is delivered and one for the service that will be recognised over time using a time-elapsed measure of progress. On 1 January 20X0, the licence is delivered and the service commences.

Entity A determines that the milestone payment is variable consideration. Because of the binary nature of the outcome (i.e., the entity will either receive the milestone payment or not), Entity A determines that the most likely amount method (discussed in section 5.2.2) is the better predictor of the amount to which it expects to be entitled. Entity A believes it is 90% probable that it will receive the CU200,000 milestone payment. Therefore, using the most likely amount method, Entity A estimates that it will receive the full CU200,000. Entity A then allocates the total transaction price of CU300,000 (variable consideration of CU200,000 plus the fixed consideration of CU100,000) to the licence and the service based on their relative stand-alone selling prices (assume this arrangement does not meet the variable consideration allocation exception). Further assume that CU200,000 is allocated to the licence and CU100,000 is allocated to the service, i.e., the components were priced at their stand-alone selling price.

On 1 January 20X0, when Entity A satisfies the performance obligation related to the licence, it recognises revenue and a contract asset of CU200,000. A contract asset is recorded (rather than a receivable) because Entity A's right to the consideration is contingent upon something other than the passage of time (i.e., Customer B achieving a specific outcome). The performance obligation associated with the service results in the recognition of a contract liability of CU100,000 as at 1 January 20X0 because Entity A paid upfront for the service.

On 31 March 20X0, related to the contract with Customer B, Entity A has a contract asset of CU200,000 (because the condition to receive consideration for the licence still has not been met) and a contract liability of CU75,000 (because CU25,000 of revenue has been recognised for one quarter of service). For presentation purposes at 31 March 20X0, Entity A nets the contract asset of CU200,000 and the contract liability of CU75,000, and presents a net contract asset of CU125,000.

After determining the net contract asset or contract liability position for a contract, entities consider the requirements in IAS 1 on classification as current or non-current in the statement of financial position, unless an entity presents its statement of financial position on a liquidity basis (as discussed above in this section).

Frequently asked questions (cont'd)

Question 10-2: How would an entity determine the presentation of two or more contracts that are required to be combined under the standard? [TRG meeting 31 October 2014 – Agenda paper no. 7]

TRG members generally agreed that the contract asset or liability would be combined (i.e., presented net) for different contracts with the same customer (or a related party of the customer) if an entity is otherwise required to combine those contracts under the standard (see section 3.3 for discussion of the criteria for combining contracts). When two or more contracts are required to be combined under the standard, the rights and obligations in the individual contracts are interdependent. Therefore, as discussed in Question 10-1, this interdependency is best reflected by combining the individual contracts as if they were a single contract. However, TRG members acknowledged that this analysis may be operationally difficult for some entities because their systems may capture data at the performance obligation level in order to comply with the recognition and measurement aspects of the standard.

Question 10-3: When would an entity offset contract assets and liabilities against other statement of financial position items (e.g., accounts receivable)? [TRG meeting 31 October 2014 – Agenda paper no. 7]

TRG members generally agreed that, because the standard does not provide requirements for offsetting, entities need to apply the requirements of other standards to determine whether offsetting is appropriate (e.g., IAS 1, IAS 32 *Financial Instruments: Presentation*). For example, if an entity has recorded a contract asset (or a receivable) and a contract liability (or refund liability) from separate contracts with the same customer (that are not required to be combined under the standard), the entity needs to look to requirements outside IFRS 15 to determine whether offsetting is appropriate.

Question 10-4: Is a refund liability a contract liability (and, thus, subject to the presentation and disclosure requirements of a contract liability)?

An entity needs to determine whether a refund liability is characterised as a contract liability based on the specific facts and circumstances of the arrangement. We believe that a refund liability typically does not meet the definition of a contract liability. When an entity concludes that a refund liability is not a contract liability, it presents the refund liability separately from any contract liability (or asset) and the refund liability is not subject to the disclosure requirements in IFRS 15.116-118 discussed in section 10.5.1 below.

When a customer pays consideration (or consideration is unconditionally due) and the entity has an obligation to transfer *goods or services* to the customer, the entity recognises a contract liability. When the entity expects to refund some or all of the *consideration* received (or receivable) from the customer, it recognises a refund liability. A refund liability generally does not represent an obligation to transfer goods or services in the future. Similar to receivables (which are considered a subset of contract assets), refund liabilities could be considered a subset of contract liabilities. We believe refund liabilities are also similar to receivables in that they are extracted from

Frequently asked questions (cont'd)

the net contract position and presented separately (if material). This conclusion is consistent with the standard's specific requirement to present the corresponding asset for expected returns separately (see section 5.4.1).[419]

If an entity concludes, based on its specific facts and circumstances, that a refund liability represents an obligation to transfer goods or services in the future, the refund liability is a contract liability subject to the disclosure requirements in IFRS 15.116-118. In addition, in that situation, the entity presents a single net contract liability or asset (i.e., including the refund liability) determined at the contract level, as discussed in Question 10-1 above.

Question 10-5: How would an entity account for a contract asset that exists when a contract is modified if the modification is treated as the termination of an existing contract and the creation of a new contract? [FASB TRG meeting 18 April 2016 – Agenda paper no. 51]

FASB TRG members generally agreed that a contract asset that exists when a contract is modified would be carried forward into the new contract if the modification is treated as the termination of an existing contract and the creation of a new contract (see section 3.4.1).

Some stakeholders questioned the appropriate accounting for contract assets when this type of modification occurs because the termination of the old contract could indicate that any remaining balances associated with the old contract must be written off.

FASB TRG members generally agreed that it is appropriate to carry forward the related contract asset in such modifications because the asset relates to a right to consideration for goods or services that have already been transferred and are distinct from those to be transferred in the future. As such, the revenue recognised to date is not reversed and the contract asset continues to be realised as amounts become due from the customer and are presented as a receivable. The contract asset that remains on the entity's statement of financial position at the date of modification continues to be subject to evaluation for impairment.

Consider the following example included in the TRG agenda paper:

Example of accounting for an existing contract asset when the contract is modified

Vendor A enters into a contract to provide a good and one year of service. The transaction price is CU4,200. The good and service are separate performance obligations, and the service is considered a series of distinct goods or services (see section 4.2.2). The stand-alone selling price for the good is CU3,000 and the stand-alone selling price for the services is CU100 per month (CU1,200 for one year). Therefore, Vendor A allocates CU3,000 to the good and CU1,200 to the services. Customer B will pay 12 equal instalments of CU350. Vendor A will invoice Customer B at the end of each month.

[419] IFRS 15.B25.

Frequently asked questions (cont'd)

Example of accounting for an existing contract asset when the contract is modified (cont'd)

At the beginning of the first month, the good is transferred to Customer B and the revenue allocated to that performance obligation (CU3,000) is recognised. Vendor A also recognises a contract asset for CU3,000 because payment of that CU3,000 is conditional upon Vendor A's performance of future services.

At the end of the first month, Vendor A recognises revenue of CU100 for progress toward complete satisfaction of the performance obligation related to the services (assuming the entity is using a time-based measure of progress). Vendor A also recognises accounts receivable of CU350 because that amount is not conditional. The contract asset, which had a balance of CU3,000 at the beginning of the month, would have a balance of CU2,750 at the end of the first month.

Vendor A continues to make similar entries for the first nine months of the contract. After nine months, CU3,900 of revenue has been recognised for the contract (CU900 of revenue for the services and CU3,000 for the good). Vendor A has a receivable for CU350 (assuming Customer B already paid the first eight instalments). In addition, Vendor A has a contract asset for CU750 (CU3,000 – (9 x (CU350 – CU100))).

At the end of nine months, the contract is modified to include one additional year of service. The fee for the last three months of the initial one-year contract is unchanged, but the agreed fee for the additional one year of services is CU50 per month, which is significantly below the stand-alone selling price of the services.

In addition, because the remaining services are a series of distinct services, Vendor A determines that the remaining services are distinct from the goods or services transferred prior to the modification. Therefore, the modification would be accounted for under IFRS 15.21(a) (i.e., as a termination of the existing contract and the creation of a new contract, as discussed in section 3.4).

At the modification date, Vendor A retains the existing contract asset of CU750 that relates to revenue previously recognised, but which has not been paid by the customer (and is not presented as a receivable). Vendor A also determines the total consideration to be allocated to the remaining performance obligations. The consideration promised by Customer B that was included in the transaction price, but not yet recognised as revenue under the original contract, is CU300 (equal to CU4,200 transaction price – CU3,900 already recognised as revenue). The additional consideration promised as part of the contract modification is CU600 (equal to 12 additional months × CU50 per month). Therefore, the total amount of consideration allocated to the remaining distinct services is CU900 (CU300 + CU600). Vendor A would allocate the CU900 to the remaining performance obligations and recognise revenue over the remaining modified contract duration. Subsequent to the contract modification, the contract asset would be evaluated and accounted for in the same manner as any other contract asset.

Frequently asked questions (cont'd)

While the FASB TRG members did not discuss this point, we believe a similar conclusion would be appropriate when accounting for an asset created under IFRS 15, such as capitalised commissions, which exists immediately before a contract modification that is treated as if it were a termination of the existing contract and creation of a new contract. Refer to Question 9-11 in section 9.3.1 for further discussion.

Question 10-6: If an entity has not transferred a good or service, when does it have an unconditional right to payment?

The standard states in IFRS 15.108 that a receivable is an entity's right to consideration that is unconditional. In general, we believe it may be difficult to assert that the entity has an unconditional right to payment when it has not transferred a good or service.

However, an entity may enter into non-cancellable contracts that provide unconditional rights to payment from the customer for services that the entity has not yet completed providing or services it will provide in the near future (e.g., amounts invoiced in advance related to a service or maintenance arrangement). When determining whether it is acceptable (or required) to recognise accounts receivable and a corresponding contract liability, the contractual terms and specific facts and circumstances supporting the existence of an unconditional right to payment should be evaluated. Factors to consider include:

(a) Does the entity have a contractual (or legal) right to invoice and receive payment from the customer for services being provided currently (and not yet completed) or being provided in the near future (e.g., amounts invoiced in advance related to a service or maintenance arrangement)?

(b) Is the advance invoice consistent with the entity's normal invoicing terms?

(c) Will the entity commence performance within a relatively short time frame of the invoice date?

(d) Is there more than one year between the advance invoice and performance?

10.2 Presentation requirements for revenue from contracts with customers (updated October 2020)

The Board decided to require entities to separately present or disclose the amount of revenue related to contracts with customers, as follows:[420]

- IFRS 15.113(a) requires an entity to disclose (or present in the statement of comprehensive income) the amount of revenue recognised from contracts with customers under IFRS 15 separately from other sources of revenue. For example, a large equipment manufacturer that both sells and leases its equipment should present (or disclose) amounts from these transactions separately.
- IFRS 15.113(b) also requires an entity to disclose impairment losses from contracts with customers separately from other impairment losses if they are not presented in the statement of comprehensive income separately. As noted in the Basis for Conclusions, the Board felt that separately disclosing the impairment losses on contracts with customers provides the most relevant information to users of financial statements.[421]

Unless required, or permitted, by another standard, IAS 1 does not permit offsetting of income and expenses within profit or loss or the statement of comprehensive income.[422]

After applying the requirements for determining the transaction price in IFRS 15, revenue recognised by an entity may include offsets, for example, for any trade discounts given and volume rebates paid by the entity to its customers. Similarly, in the ordinary course of business, an entity may undertake other transactions that do not generate revenue, but are incidental to the main revenue-generating activities. When this presentation reflects the substance of the transaction or other event, IAS 1 permits an entity to present "the results of such transactions … by netting any income with related expenses arising on the same transaction".[423] An example given in IAS 1 is the presentation of gains and losses on the disposal of non-current assets by deducting from the amount of consideration on disposal the carrying amount of the asset and related selling expenses.[424]

[420] IFRS 15.BC332.
[421] IFRS 15.BC334.
[422] IAS 1.32.
[423] IAS 1.34.
[424] IAS 1.34(a).

Frequently asked questions

Question 10-7: Can income outside the scope of IFRS 15 be presented as revenue in the income statement?

It depends. Entities need to consider the definition of revenue. IFRS 15 defines revenue as "Income arising in the course of an entity's ordinary activities", but the standard excludes some revenue contracts from its scope (e.g., leases). According to the 2010 *Conceptual Framework for Financial Reporting* (which applied when IFRS 15 was issued), revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent".[425]

While 'ordinary activities' is not defined, if the transaction involves the sale of an asset, the nature of the asset and the purpose for which it was held by the entity may be informative. For example, inventory accounted for under IAS 2 is, by definition, held for use in production or sale in the ordinary course of business.[426] Therefore, the sale of that inventory is typically part of an entity's ordinary activities. Conversely, property, plant and equipment accounted for under IAS 16 is, by definition, held for use by the entity for more than one period.[427] Likewise, IAS 38 excludes from its scope intangible assets held for sale in the ordinary course of business.[428] Therefore, their disposal is not typically part of an entity's ordinary activities and the difference between the net disposal proceeds and the carrying amount of the asset is not recognised as revenue under IFRS 15, but as a gain or loss on disposal. This was reiterated by the IFRS IC in June 2020, as is discussed in section 2.2.1.[429]

If an entity receives consideration in the course of its ordinary activities that is outside the scope of IFRS 15, it may present that income as revenue in the income statement. However, this income will need to be presented either separately from revenue from contracts with customers on the income statement or disclosed separately within the notes. This is because, as mentioned above, entities are required to present in the statement of comprehensive income, or disclose within the notes, the amount of revenue recognised from contracts with customers separately from other sources of revenue.

IFRS 15 does not explicitly require an entity to use the term 'revenue from contracts with customers'. Therefore, entities might use a different terminology in their financial statements to describe revenue arising from transactions that are within the scope of IFRS 15. However, entities should ensure the terms used are not misleading and allow users to distinguish revenue from contracts with customers from other sources of revenue.

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425 2010 *Conceptual Framework for Financial Reporting*, paragraph 4.29. See paragraph BC4.96 of the 2018 *Conceptual Framework for Financial Reporting;* when effective (for annual periods beginning of or after 1 January 2020), the 2018 *Conceptual Framework for Financial Reporting* will no longer contain a discussion about revenue and gains and losses. However, the definition of revenue in IFRS 15 will remain unchanged. The IASB does not expect the removal of that discussion to cause any changes in practice.

426 IAS 2.6.

427 IAS 16.6.

428 IAS 38.3(a).

429 *IFRIC Update*, June 2020, available on the IASB's website.

10.3 Other presentation considerations

The standard also includes presentation requirements for products expected to be returned and for those that contain a significant financing component. Refer to sections 5.4.1 and 5.5.2 for presentation considerations related to rights of return and significant financing components, respectively. Also refer to section 9.3.3 for presentation considerations related to capitalised contract costs to obtain and fulfil a contract.

Frequently asked questions

Question 10-8: How should entities classify shipping and handling costs in the income statement?

Under IFRS 15, an entity needs to determine whether shipping and handling is a separate promised service to the customer or if they are activities to fulfil the promise to transfer the good (see section 4.1). Shipping and handling activities that are performed before the customer obtains control of the related good will be activities to fulfil its promise to transfer control of the good. If shipping and handling activities are performed after a customer obtains control of the related good, shipping and handling is a promised service to the customer and an entity needs to determine whether it acts as a principal or an agent in providing those services.

If an entity determines that the shipping and handling activities are related to a promised good or service to the customer (either the promise to transfer control of the good or the promise to provide shipping and handling services) and the entity is the principal (rather than the agent), we believe the related costs should be classified as cost of sales because the costs would be incurred to fulfil a revenue obligation. However, if the entity determines that shipping and handling is a separate promised service to the customer and it is acting as an agent in providing those services, the related revenue to be recognised for shipping and handling services would be net of the related costs.

We believe entities need to apply judgement to determine how to classify shipping and handling costs when it is not related to a promised good or service to the customer. This is because IFRS does not specifically address how entities should classify these costs. While not a requirement of IFRS 15, we would encourage entities to disclose the amount of these costs and the line item or items on the income statement that include them, if they are significant.

Question 10-9: How should capitalised contract costs and their amortisation be classified and presented in the statement of financial position and statement of profit and loss and other comprehensive income, respectively?

See response to Question 9-24 in section 9.3.3.

10.4 Disclosure objective and general requirements

In response to criticism that the legacy revenue recognition disclosures are inadequate, the Board sought to create a comprehensive and coherent set of disclosures. As a result, IFRS 15 described the overall objective of the disclosures, consistent with other recent standards, as follows:

Extract from IFRS 15

110. The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity shall disclose qualitative and quantitative information about all of the following:

(a) its contracts with customers (see paragraphs 113–122);

(b) the significant judgements, and changes in the judgements, made in applying this Standard to those contracts (see paragraphs 123–126); and

(c) any assets recognised from the costs to obtain or fulfil a contract with a customer in accordance with paragraph 91 or 95 (see paragraphs 127–128).

Each of these disclosure requirements is discussed further below. To assist entities in determining the required disclosures, Appendix A includes an extract from EY's *IFRS Disclosure Checklist*.

The standard requires that an entity consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. The level of aggregation or disaggregation of disclosures requires judgement. Entities are required to ensure that useful information is not obscured (by either the inclusion of a large amount of insignificant detail or the aggregation of items that have substantially different characteristics). An entity does not need to disclose information in accordance with IFRS 15 if it discloses that information in accordance with another standard.

As explained in the Basis for Conclusions, many preparers raised concerns that they would need to provide voluminous disclosures at a cost that may outweigh any potential benefits.[430] As summarised above, the Board clarified the disclosure objective and indicated that the disclosures described in the standard are not meant to be a checklist of minimum requirements. That is, entities do not need to include disclosures that are not relevant or are not material to them. In addition, the Board decided to require qualitative disclosures instead of tabular reconciliations for certain disclosures.

[430] IFRS 15.BC327, BC331.

How we see it

Entities should review their disclosures in each reporting period to determine whether they have met the standard's disclosure objective to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. For example, some entities may make large payments to customers that do not represent payment for a distinct good or service and therefore reduce the transaction price and affect the amount and timing of revenue recognised. Although there are no specific requirements in the standard to disclose balances related to consideration paid or payable to a customer, an entity may need to disclose qualitative and/or quantitative information about those arrangements to meet the objective of the disclosure requirements in the standard if the amounts are material.

The disclosures are required for (and as at) each annual period for which a statement of comprehensive income and a statement of financial position are presented.

10.5 Specific disclosure requirements

The following illustration depicts the disclosure requirements, which are discussed further below by category:

Category	Sub-category/ Type	Required disclosure*
Contracts with customers	Contracts with customers *Quantitative*	If not presented separately in the statement of comprehensive income: ▸ The amount of revenue recognised from contracts with customers (i.e., IFRS 15) separately from other sources of revenue ▸ Any impairment losses from contract with customers separately from other impairment losses
	Disaggregation of revenue *Quantitative and qualitative*	▸ Disaggregation of revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors ▸ Sufficient information to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue and revenue information that is disclosed for each reportable segment, if the entity applies IFRS 8 *Operating Segments*
	Contract balances *Quantitative and qualitative*	▸ Opening and closing balances of receivables, contract assets and contract liabilities ▸ Revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period ▸ Explanation of how the timing of satisfaction of performance obligations relates to the typical timing of payment and the effect thereof on contract assets and liabilities ▸ Explanation of the significant changes in the contract asset and contract liability balances during the reporting period

Category	Sub-category/ Type	Required disclosure*
Contracts with customers	Performance obligations *Quantitative and qualitative*	▸ Descriptive information about an entity's performance obligations (i.e., when typically satisfied, significant payment terms, nature of goods and services, obligations for returns, refunds, and other similar obligations, and types of warranties and related obligations) ▸ Revenue recognised in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods ▸ Aggregate amount of the transaction price allocated to performance obligations that are unsatisfied (or partially satisfied) as of the end of the reporting period and explanation of when the related revenue is expected to be recognised (subject to certain optional exemptions)

Significant judgements	N/A
	
	Qualitative
		▸ Judgements (and changes in judgements) made in determining the timing of satisfaction of performance obligations, the transaction price and amounts allocated to performance obligations, including:
		  ▸ For performance obligations satisfied over time, the method used to recognise revenue and why the method faithfully depicts the transfer of goods and services
		  ▸ For performance obligations satisfied at a point in time, significant judgements made in evaluating when control transfers to a customer
		  ▸ Methods, inputs and assumptions used to estimate variable consideration, adjust consideration for the effects of time value of money, measure non-cash consideration and apply the constraint
		  ▸ Methods, inputs and assumptions used to estimate stand-alone selling prices and the use of any allocation exceptions
		  ▸ Methods, inputs and assumptions used to measure obligations for returns, refunds and other similar obligations

Costs to obtain or fulfil a contract	N/A *Quantitative and qualitative*	▸ Judgements made in determining the amount of costs to obtain or fulfil a contract ▸ Method used to determine amortisation for each reporting period ▸ Closing balances of capitalised contract costs ▸ Amount of amortisation and any impairment losses recognised in the period

Practical expedients	N/A
	
	Qualitative
		▸ Use of the following practical expedients:
		  ▸ Practical expedient on the existence of a significant financing component
		  ▸ Practical expedient on expensing incremental costs of obtaining a contract

* As discussed in section 10.4, the IASB decided to include disclosure requirements in IFRS 15 to help an entity meet the standard's disclosure objective. However, these disclosures should not be viewed as a checklist of minimum requirements. Refer to section 10.6 for information on interim disclosure requirements.

10.5.1 Contracts with customers (updated September 2019)

The majority of the standard's disclosures relate to an entity's contracts with customers. These disclosures include disaggregation of revenue, information about contract asset and liability balances and information about an entity's performance obligations.

Disaggregation of revenue

Entities are required to disclose disaggregated revenue information to illustrate how the nature, amount, timing and uncertainty about revenue and cash flows are affected by economic factors. This is the only revenue disclosure requirement that is required in both an entity's interim and annual financial statements.

As noted above, an entity is required to separately disclose any impairment losses recognised in accordance with IFRS 9 on receivables or contract assets arising from contracts with customers. However, IFRS 15 does not require entities to further disaggregate such losses for uncollectible amounts.

While the standard does not specify precisely how revenue should be disaggregated, the application guidance suggests categories for entities to consider. The application guidance indicates that the most appropriate categories for a particular entity depend on its facts and circumstances, but an entity needs to consider how it disaggregates revenue in other communications (e.g., press releases, information regularly reviewed by the chief operating decision maker) when determining which categories are most relevant and useful.

The standard includes the following application guidance on the required disaggregation of revenue disclosures:

Extract from IFRS 15

B88. When selecting the type of category (or categories) to use to disaggregate revenue, an entity shall consider how information about the entity's revenue has been presented for other purposes, including all of the following:

(a) disclosures presented outside the financial statements (for example, in earnings releases, annual reports or investor presentations);

(b) information regularly reviewed by the chief operating decision maker for evaluating the financial performance of operating segments; and

(c) other information that is similar to the types of information identified in paragraph B88(a) and (b) and that is used by the entity or users of the entity's financial statements to evaluate the entity's financial performance or make resource allocation decisions.

Extract from IFRS 15 (cont'd)

B89. Examples of categories that might be appropriate include, but are not limited to, all of the following:

(a) type of good or service (for example, major product lines);

(b) geographical region (for example, country or region);

(c) market or type of customer (for example, government and non-government customers);

(d) type of contract (for example, fixed-price and time-and-materials contracts);

(e) contract duration (for example, short-term and long-term contracts);

(f) timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time); and

(g) sales channels (for example, goods sold directly to consumers and goods sold through intermediaries).

As noted in the Basis for Conclusions, the Board decided not to prescribe a specific characteristic of revenue as the basis for disaggregation because it intended for entities to make this determination based on entity-specific and/or industry-specific factors that are the most meaningful for their businesses. The Board acknowledged that an entity may need to use more than one type of category to disaggregate its revenue.[431]

We believe that, when determining categories for disaggregation of revenue, entities need to analyse specific risk factors for each of their revenue streams to determine the appropriate level of revenue disaggregation that will be beneficial to users of the financial statements. If certain risk factors could lead to changes in the nature, amount, timing and uncertainty of revenue recognition and cash flows, those factors will need to be considered as part of the evaluation.

IFRS 15.112 clarifies that an entity does not have to duplicate disclosures required by another standard. For example, an entity that provides disaggregated revenue disclosures as part of its segment disclosures, in accordance with IFRS 8 *Operating Segments*, does not need to separately provide disaggregated revenue disclosures if the segment-related disclosures are sufficient to illustrate how the nature, amount, timing and uncertainty about revenue and cash flows from contracts with customers are affected by economic factors and are presented on a basis consistent with IFRS.

However, segment disclosures may not be sufficiently disaggregated to achieve the disclosure objectives of IFRS 15. The IASB noted in the Basis for Conclusions that segment disclosures on revenue may not always provide users of financial statements with enough information to help them understand the composition of revenue recognised in the period.[432] If an entity applies IFRS 8, it is required under IFRS 15.115 to explain the relationship between the disaggregated revenue information and revenue information that is disclosed for each reportable segment. Users of the financial statements believe this information is critical to their ability to understand not only the composition of revenue, but also how revenue relates to other information provided in the segment disclosures. Entities can provide this information in a tabular or a narrative form.

[431] IFRS 15.B87, BC336.
[432] IFRS 15.BC340.

How we see it

Regulators may review publicly provided information (e.g., investor presentations, press releases) in order to evaluate whether entities have met the objectives of this disclosure requirement. In accordance with IFRS 15.B88, an entity needs to consider how information about its revenue has been presented for other purposes, including information disclosed outside the financial statements, information regularly reviewed by the chief operating decision maker and other similar information used by the entity or users of the financial statements to evaluate the entity's financial performance or to make resource allocation decisions.

As discussed above, to help determine the appropriate level of revenue disaggregation that is beneficial to users of the financial statements, entities should analyse specific risk factors for each revenue stream. Different risk factors for revenue streams may indicate when disaggregation is required.

It is important to note that IFRS 15 and IFRS 8 have different objectives. The objective of the segment reporting requirements in IFRS 8 is to enable users of the financial statements to evaluate the nature and financial effects of the business activities in which an entity engages and the economic environment in which it operates.[433] These disclosure requirements are largely based on how the chief operating decision maker (e.g., chief executive officer or chief operating officer) allocates resources to the operating segments of the entity and assesses their performance.[434] They also permit aggregation in certain situations. In contrast, IFRS 15 disclosure requirements focus on how the revenues and cash flows from contracts with customers are affected by economic factors and do not have similar aggregation criteria. As noted above, if an entity concludes that it is necessary to provide disaggregated revenue disclosures along with the segment disclosures required under IFRS 8, it is required under IFRS 15 to explain the relationship between the disclosures.

The Board provided an example of the disclosures for disaggregation of revenue, as follows:

Extract from IFRS 15

Example 41 — Disaggregation of revenue—quantitative disclosure (IFRS 15.IE210-IE211)

An entity reports the following segments: consumer products, transportation and energy, in accordance with IFRS 8 *Operating Segments*. When the entity prepares its investor presentations, it disaggregates revenue into primary geographical markets, major product lines and timing of revenue recognition (ie goods transferred at a point in time or services transferred over time).

The entity determines that the categories used in the investor presentations can be used to meet the objective of the disaggregation disclosure requirement in paragraph 114 of IFRS 15, which is to disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. The following table illustrates the disaggregation disclosure by primary geographical market, major product line and timing of revenue recognition, including a reconciliation of how the disaggregated revenue ties in with the consumer products, transportation and energy segments, in accordance with paragraph 115 of IFRS 15.

[433] IFRS 8.20.
[434] IFRS 8.5(b).

Extract from IFRS 15 (cont'd)

Segments	Consumer products	Transport	Energy	Total
	CU	CU	CU	CU
Primary geographical markets				
North America	990	2,250	5,250	8,490
Europe	300	750	1,000	2,050
Asia	700	260	-	960
	1,990	3,260	6,250	11,500
Major goods/service lines				
Office Supplies	600	-	-	600
Appliances	990	-	-	990
Clothing	400	-	-	400
Motorcycles	-	500	-	500
Automobiles	-	2,760	-	2,760
Solar Panels	-	-	1,000	1,000
Power Plant	-	-	5,250	5,250
	1,990	3,260	6,250	11,500
Timing of revenue recognition				
Goods transferred at a point in time	1,990	3,260	1,000	6,250
Services transferred over time	-	-	5,250	5,250
	1,990	3,260	6,250	11,500

Contract balances

The Board noted in the Basis for Conclusions that users of the financial statements need to understand the relationship between the revenue recognised and changes in the overall balances of an entity's total contract assets and liabilities during a particular reporting period.[435] As a result, the Board included the following disclosure requirements for an entity's contract balances and changes in the balances:

Extract from IFRS 15

116. An entity shall disclose all of the following:

(a) the opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed;

(b) revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period; and

(c) revenue recognised in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (for example, changes in transaction price).

[435] IFRS 15.BC341.

Extract from IFRS 15 (cont'd)

117. An entity shall explain how the timing of satisfaction of its performance obligations (see paragraph 119(a)) relates to the typical timing of payment (see paragraph 119(b)) and the effect that those factors have on the contract asset and the contract liability balances. The explanation provided may use qualitative information.

118. An entity shall provide an explanation of the significant changes in the contract asset and the contract liability balances during the reporting period. The explanation shall include qualitative and quantitative information. Examples of changes in the entity's balances of contract assets and contract liabilities include any of the following:

(a) changes due to business combinations;

(b) cumulative catch-up adjustments to revenue that affect the corresponding contract asset or contract liability, including adjustments arising from a change in the measure of progress, a change in an estimate of the transaction price (including any changes in the assessment of whether an estimate of variable consideration is constrained) or a contract modification;

(c) impairment of a contract asset;

(d) a change in the time frame for a right to consideration to become unconditional (ie for a contract asset to be reclassified to a receivable); and

(e) a change in the time frame for a performance obligation to be satisfied (ie for the recognition of revenue arising from a contract liability).

Entities are permitted to disclose information about contract balances, and changes therein, as they deem to be most appropriate, which would include a combination of tabular and narrative information. The IASB explained in the Basis for Conclusions that these disclosures are intended to provide financial statement users with information they requested on when contract assets are typically transferred to accounts receivable or collected as cash and when contract liabilities are recognised as revenue.[436]

In addition to the disclosures on contract balances and changes, the standard requires entities to disclose the amount of revenue recognised in the period that relates to amounts allocated to performance obligations that were satisfied (or partially satisfied) in previous periods (e.g., due to a change in transaction price or in estimates related to the constraint on revenue recognised). This disclosure requirement applies to sales-based and usage-based royalties received from a customer in exchange for a licence of intellectual property that are recognised as revenue in a reporting period, but relate to performance obligations satisfied (or partially satisfied) in previous periods (e.g., sales-based royalties recognised in the current period that are related to a right-to-use licence previously transferred to a customer). As noted in the Basis for Conclusions, the Board noted that this information is not required elsewhere in the financial statements and provides relevant information about the timing of revenue recognised that was not a result of performance in the current period.[437]

[436] IFRS 15.BC346.
[437] IFRS 15.BC347.

The illustration below is an example of how an entity may fulfil these requirements:

Illustration 10-3 — Contract asset and liability disclosures

Company A discloses receivables from contracts with customers separately in the statement of financial position. To comply with the other disclosure requirements for contract assets and liabilities, Company A includes the following information in the notes to the financial statements:

	20X1	20X0	20X9
Contract asset	CU1,500	CU2,250	CU1,800
Contract liability	CU(200)	CU(850)	CU(500)
Revenue recognised in the period from:			
Amounts included in contract liability at the beginning of the period	CU650	CU200	CU100
Performance obligations satisfied in previous periods	CU200	CU125	CU200

We receive payments from customers based on a billing schedule, as established in our contracts. Contract asset relates to our conditional right to consideration for our completed performance under the contract. Accounts receivable are recognised when the right to consideration becomes unconditional. Contract liability relates to payments received in advance of performance under the contract. Contract liabilities are recognised as revenue as (or when) we perform under the contract. In addition, contract asset decreased in 20X1 due to a contract asset impairment of CU400 relating to the early cancellation of a contract with a customer.

How we see it

IFRS 15.116(a) requires entities to separately disclose contract balances from contracts with customers. Therefore, it is necessary for entities that have material receivables from non-IFRS 15 contracts to separate these balances for disclosure purposes. For example, an entity may have accounts receivable relating to leasing contracts that would need to be disclosed separately from accounts receivable related to contracts with customers.

Entities need to make sure they have appropriate systems, policies and procedures and internal controls in place to collect and disclose the required information.

Performance obligations

To help users of financial statements analyse the nature, amount, timing and uncertainty about revenue and cash flows arising from contracts with customers, the Board decided to require disclosures about an entity's performance obligations. As noted in the Basis for Conclusions, legacy IFRS required entities to disclose their accounting policies for recognising revenue, but users of financial statements had commented that many entities provided a 'boilerplate' description that did not explain how the policy related to the contracts they entered into with customers.[438] To address this criticism, IFRS 15 requires an entity to provide more descriptive information about its performance obligations.

An entity is also required to disclose information about remaining performance obligations and the amount of the transaction price allocated to such obligations, including an explanation of when it expects to recognise the amount(s) in its financial statements.

Both quantitative and qualitative information are required as follows:

Extract from IFRS 15

Performance obligations

119. An entity shall disclose information about its performance obligations in contracts with customers, including a description of all of the following:

(a) when the entity typically satisfies its performance obligations (for example, upon shipment, upon delivery, as services are rendered or upon completion of service), including when performance obligations are satisfied in a bill-and-hold arrangement;

(b) the significant payment terms (for example, when payment is typically due, whether the contract has a significant financing component, whether the consideration amount is variable and whether the estimate of variable consideration is typically constrained in accordance with paragraphs 56–58);

(c) the nature of the goods or services that 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);

(d) obligations for returns, refunds and other similar obligations; and

(e) types of warranties and related obligations.

Transaction price allocated to the remaining performance obligations

120. An entity shall disclose the following information about its remaining performance obligations:

(a) the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period; and

(b) an explanation of when the entity expects to recognise as revenue the amount disclosed in accordance with paragraph 120(a), which the entity shall disclose in either of the following ways:

  (i) on a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations; or

  (ii) by using qualitative information.

[438] IFRS 15.BC354.

Extract from IFRS 15 (cont'd)

121. As a practical expedient, an entity need not disclose the information in paragraph 120 for a performance obligation if either of the following conditions is met:

(a) the performance obligation is part of a contract that has an original expected duration of one year or less; or

(b) the entity recognises revenue from the satisfaction of the performance obligation in accordance with paragraph B16.

122. An entity shall explain qualitatively whether it is applying the practical expedient in paragraph 121 and whether any consideration from contracts with customers is not included in the transaction price and, therefore, not included in the information disclosed in accordance with paragraph 120. For example, an estimate of the transaction price would not include any estimated amounts of variable consideration that are constrained (see paragraphs 56–58).

During the development of the standard, many users of financial statements commented that information about the amount and timing of revenue that an entity expects to recognise from its existing contracts would be useful in their analyses of revenue, especially for long-term contracts with significant unrecognised revenue.[439] In addition, the Board observed that a number of entities often voluntarily disclose such 'backlog' information. However, this information is typically presented outside the financial statements and may not be comparable across entities because there is no common definition of backlog.

As summarised in the Basis for Conclusions, the Board's intention in including the disclosure requirements in IFRS 15.120 is to provide users of an entity's financial statements with additional information about the following:

(a) the amount and expected timing of revenue to be recognised from the remaining performance obligations in existing contracts;

(b) trends relating to the amount and expected timing of revenue to be recognised from the remaining performance obligations in existing contracts;

(c) risks associated with expected future revenue (for example, some observe that revenue is more uncertain if an entity does not expect to satisfy a performance obligation until a much later date); and

(d) the effect of changes in judgements or circumstances on an entity's revenue."[440]

This disclosure can be provided on either a quantitative basis (e.g., amounts to be recognised in given time bands, such as between one and two years and between two and three years) or by disclosing a mix of quantitative and qualitative information. In addition, this disclosure would only include amounts related to performance obligations in the current contract. For example, expected contract renewals that have not been executed and do not represent material rights are not performance obligations in the current contract. As such, an entity does not disclose amounts related to such renewals. However, if an entity concludes that expected contract renewals represents a material right to acquire goods or services in the future (and, therefore, was a separate performance obligation – see section 4.6), the entity includes in its disclosure the consideration attributable to the material right for the options that have not yet been exercised (i.e., the unsatisfied performance obligation(s)).

[439] IFRS 15.BC348-349.
[440] IFRS 15.BC350.

The disclosure of the transaction price allocated to the remaining performance obligations does not include consideration that has been excluded from the transaction price. However, the standard requires entities to disclose qualitatively whether any consideration is not included in the transaction price and, therefore, is not included in the disclosure of the remaining performance obligations (e.g., variable consideration amounts that are constrained and, therefore, excluded from the transaction price).

The Board also provided a practical expedient under which an entity need not disclose the amount of the remaining performance obligations for contracts with an original expected duration of less than one year or those that meet the requirements of the right to invoice practical expedient in IFRS 15.B16 (see IFRS 15.121). As explained in section 7.1.4, the right to invoice practical expedient permits an entity that is recognising revenue over time to recognise revenue as invoiced if the entity's right to payment is an amount that corresponds directly with the value to the customer of the entity's performance to date.[441] For example, an entity is not required to make the disclosure for a three-year service contract under which it has a right to invoice the customer a fixed amount for each hour of service provided. If an entity uses this disclosure practical expedient, it is required to qualitatively disclose that fact.[442]

How we see it

Entities need to make sure they have appropriate systems, policies and procedures and internal controls in place to collect and disclose the required information.

FASB differences

ASC 606 contains optional exemptions that are consistent with the optional practical expedients included in IFRS 15.121. However, ASC 606 includes additional optional exemptions (that IFRS 15 does not) to allow entities not to make quantitative disclosures about remaining performance obligations in certain cases and require entities that use any of the new or existing optional exemptions (previously referred to as practical expedients) to expand their qualitative disclosures.

[441] IFRS 15.121.
[442] IFRS 15.122.

The standard provides the following examples of the required disclosures on remaining performance obligations:

Extract from IFRS 15

Example 42 — Disclosure of the transaction price allocated to the remaining performance obligations (IFRS 15.IE212-IE219)

On 30 June 20X7, an entity enters into three contracts (Contracts A, B and C) with separate customers to provide services. Each contract has a two-year non-cancellable term. The entity considers the requirements in paragraphs 120–122 of IFRS 15 in determining the information in each contract to be included in the disclosure of the transaction price allocated to the remaining performance obligations at 31 December 20X7.

Contract A

Cleaning services are to be provided over the next two years typically at least once per month. For services provided, the customer pays an hourly rate of CU25.

Because the entity bills a fixed amount for each hour of service provided, the entity has a right to invoice the customer in the amount that corresponds directly with the value of the entity's performance completed to date in accordance with paragraph B16 of IFRS 15. Consequently, no disclosure is necessary if the entity elects to apply the practical expedient in paragraph 121(b) of IFRS 15.

Contract B

Cleaning services and lawn maintenance services are to be provided as and when needed with a maximum of four visits per month over the next two years. The customer pays a fixed price of CU400 per month for both services. The entity measures its progress towards complete satisfaction of the performance obligation using a time-based measure.

The entity discloses the amount of the transaction price that has not yet been recognised as revenue in a table with quantitative time bands that illustrates when the entity expects to recognise the amount as revenue. The information for Contract B included in the overall disclosure is, as follows:

	20X8	20X9	Total
	CU	CU	CU
Revenue expected to be recognised on this contract as of 31 December 20X7	4,800[(a)]	2,400[(b)]	7,200

(a) CU4,800 = CU400 × 12 months.

(b) CU2,400 = CU400 × 6 months.

Extract from IFRS 15 (cont'd)

Contract C

Cleaning services are to be provided as and when needed over the next two years. The customer pays fixed consideration of CU100 per month plus a one-time variable consideration payment ranging from CU0–CU1,000 corresponding to a one-time regulatory review and certification of the customer's facility (ie a performance bonus). The entity estimates that it will be entitled to CU750 of the variable consideration. On the basis of the entity's assessment of the factors in paragraph 57 of IFRS 15, the entity includes its estimate of CU750 of variable consideration in the transaction price because it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. The entity measures its progress towards complete satisfaction of the performance obligation using a time-based measure.

The entity discloses the amount of the transaction price that has not yet been recognised as revenue in a table with quantitative time bands that illustrates when the entity expects to recognise the amount as revenue. The entity also includes a qualitative discussion about any significant variable consideration that is not included in the disclosure. The information for Contract C included in the overall disclosure is as follows:

	20X8	20X9	Total
	CU	CU	CU
Revenue expected to be recognised on this contract as of 31 December 20X7	1,575[(a)]	788[(b)]	2,363

(a) Transaction price = CU3,150 (CU100 × 24 months + CU750 variable consideration) recognised evenly over 24 months at CU1,575 per year.

(b) CU1,575 ÷ 2 = CU788 (ie for 6 months of the year).

In addition, in accordance with paragraph 122 of IFRS 15, the entity discloses qualitatively that part of the performance bonus has been excluded from the disclosure because it was not included in the transaction price. That part of the performance bonus was excluded from the transaction price in accordance with the requirements for constraining estimates of variable consideration.

The standard also provides an example of how an entity could make the disclosure required by IFRS 15.120(b) using qualitative information (instead of quantitatively, using time bands), as follows:

Extract from IFRS 15

Example 43 — Disclosure of the transaction price allocated to the remaining performance obligations—qualitative disclosure (IFRS 15.IE220-IE221)

On 1 January 20X2, an entity enters into a contract with a customer to construct a commercial building for fixed consideration of CU10 million. The construction of the building is a single performance obligation that the entity satisfies over time. As of 31 December 20X2, the entity has recognised CU3.2 million of revenue. The entity estimates that construction will be completed in 20X3, but it is possible that the project will be completed in the first half of 20X4.

Extract from IFRS 15 (cont'd)

At 31 December 20X2, the entity discloses the amount of the transaction price that has not yet been recognised as revenue in its disclosure of the transaction price allocated to the remaining performance obligations. The entity also discloses an explanation of when the entity expects to recognise that amount as revenue. The explanation can be disclosed either on a quantitative basis using time bands that are most appropriate for the duration of the remaining performance obligation or by providing a qualitative explanation. Because the entity is uncertain about the timing of revenue recognition, the entity discloses this information qualitatively as follows:

> 'As of 31 December 20X2, the aggregate amount of the transaction price allocated to the remaining performance obligation is CU6.8 million and the entity will recognise this revenue as the building is completed, which is expected to occur over the next 12–18 months.'

Frequently asked questions

Question 10-10: If an entity does not meet the criteria to use the 'right to invoice' practical expedient, can it still use the disclosure practical expedient regarding the amount of transaction price allocated to remaining performance obligations? [TRG meeting 13 July 2015 – Agenda paper no. 40]

Members of the TRG generally agreed that the standard is clear that an entity can only use the practical expedient to avoid disclosing the amount of the transaction price allocated to remaining performance obligations for contracts: (a) with an original expected duration of less than one year; or (b) that qualify for the 'right to invoice' practical expedient. If a contract does not meet either of these criteria, an entity must disclose the information about remaining performance obligations that is required by IFRS 15.120. However, under these requirements, an entity is able to qualitatively describe any consideration that is not included in the transaction price (e.g., any estimated amount of variable consideration that is constrained).

Stakeholders had questioned whether an entity can still use this disclosure practical expedient if it determines that it has not met the criteria to use the right to invoice practical expedient (e.g., because there is a substantive contractual minimum payment or a volume discount).

10.5.2 Significant judgements

The standard specifically requires disclosure of significant accounting estimates and judgements (and changes in those judgements) made in determining the transaction price, allocating the transaction price to performance obligations and determining when performance obligations are satisfied.

IFRS has general requirements requiring disclosures about significant accounting estimates and judgements made by an entity. Because of the importance placed on revenue by users of financial statements, as noted in the Basis for Conclusions on IFRS 15, the Board decided to require specific disclosures about the estimates used and the judgements made in determining the amount and timing of revenue recognition.[443] These requirements exceed those in

[443] IFRS 15.BC355.

the general requirements for significant judgements and accounting estimates required by IAS 1 and are discussed in more detail below.[444]

Determining the timing of satisfaction of performance obligations

IFRS 15 requires entities to provide disclosures about the significant judgements made in determining the timing of satisfaction of performance obligations. The disclosure requirements for performance obligations that are satisfied over time differ from those satisfied at a point in time, but the objective is similar – to disclose the judgements made in determining the timing of revenue recognition. Entities must disclose the following information:

Extract from IFRS 15

124. For performance obligations that an entity satisfies over time, an entity shall disclose both of the following:

(a) the methods used to recognise revenue (for example, a description of the output methods or input methods used and how those methods are applied); and

(b) an explanation of why the methods used provide a faithful depiction of the transfer of goods or services.

125. For performance obligations satisfied at a point in time, an entity shall disclose the significant judgements made in evaluating when a customer obtains control of promised goods or services.

When an entity has determined that a performance obligation is satisfied over time, IFRS 15 requires the entity to select a single revenue recognition method for each performance obligation that best depicts the entity's performance in transferring the goods or services. Entities must disclose the method used to recognise revenue.

For example, assume an entity enters into a contract to refurbish a multi-level building for a customer and the work is expected to take two years. The entity concludes that the promised refurbishment service is a single performance obligation satisfied over time and it decides to measure progress using a percentage of completion method, based on the costs incurred. The entity discloses the method used, how it has been applied to the contract and why the method selected provides a faithful depiction of the transfer of goods or services.

When an entity has determined that a performance obligation is satisfied at a point in time, the standard requires the entity to disclose the significant judgements made in evaluating when the customer obtains control of the promised goods or services. For example, an entity needs to consider the indicators of the transfer of control listed in IFRS 15.38 to determine when control transfers and disclose the significant judgements made in reaching that conclusion.

[444] See IAS 1.122–133.

Determining the transaction price and the amounts allocated to performance obligations

Entities often exercise significant judgement when estimating the transaction prices of their contracts, especially when those estimates involve variable consideration.

Furthermore, significant judgement may be required when allocating the transaction price, including estimating stand-alone selling prices; for example, it is likely that entities will need to exercise judgement when determining whether a customer option gives rise to a material right (see section 4.6) and in estimating the stand-alone selling price for those material rights.

Given the importance placed on revenue by financial statement users, the standard requires entities to disclose qualitative information about the methods, inputs and assumptions used in their annual financial statements, as follows:[445]

Extract from IFRS 15

126. An entity shall disclose information about the methods, inputs and assumptions used for all of the following:

(a) determining the transaction price, which includes, but is not limited to, estimating variable consideration, adjusting the consideration for the effects of the time value of money and measuring non-cash consideration;

(b) assessing whether an estimate of variable consideration is constrained;

(c) allocating the transaction price, including estimating stand-alone selling prices of promised goods or services and allocating discounts and variable consideration to a specific part of the contract (if applicable); and

(d) measuring obligations for returns, refunds and other similar obligations.

How we see it

Entities with diverse contracts need to ensure they have the processes and procedures in place to capture all of the different methods, inputs and assumptions used in determining the transaction price and allocating it to performance obligations.

[445] IFRS 15.BC355.

10.5.3 Assets recognised from the costs to obtain or fulfil a contract

As discussed in section 9.3, the standard specifies the accounting for costs an entity incurs to obtain and fulfil a contract to provide goods or services to customers. IFRS 15 requires entities to disclose information about the assets recognised to help users understand the types of costs recognised as assets and how those assets are subsequently amortised or impaired. These disclosure requirements are as follows:

Extract from IFRS 15

127. An entity shall describe both of the following:

(a) the judgements made in determining the amount of the costs incurred to obtain or fulfil a contract with a customer (in accordance with paragraph 91 or 95); and

(b) the method it uses to determine the amortisation for each reporting period.

128. An entity shall disclose all of the following:

(a) the closing balances of assets recognised from the costs incurred to obtain or fulfil a contract with a customer (in accordance with paragraph 91 or 95), by main category of asset (for example, costs to obtain contracts with customers, pre-contract costs and setup costs); and

(b) the amount of amortisation and any impairment losses recognised in the reporting period.

Entities are required to disclose the judgements made in determining the amount of costs that were incurred to obtain or fulfil contracts with customers that meet the criteria for capitalisation, as well as the method the entity uses to amortise the assets recognised. For example, for costs to obtain a contract, an entity that capitalises commission costs upon the signing of each contract needs to describe the judgements used to determine the commission costs that qualified as costs incurred to obtain a contract with a customer, as well as the determination of the amortisation period.

Frequently asked questions

Question 10-11: How should capitalised contract costs and their amortisation be classified and presented in the statement of financial position and statement of profit and loss and other comprehensive income, respectively?

See response to Question 9-24 in section 9.3.3.

10.5.4 Practical expedients

The standard allows entities to use several practical expedients. IFRS 15.129 requires entities to disclose their use of two practical expedients: (a) the practical expedient in IFRS 15.63 associated with the determination of whether a significant financing component exists (see section 5.5); and (b) the expedient in IFRS 15.94 for recognising an immediate expense for certain incremental costs of obtaining a contract with a customer (see section 9.3.1).

In addition, entities are required to disclose the use of the disclosure practical expedient in IFRS 15.121 (which permits an entity not to disclose information about remaining performance obligations if one of the conditions in the paragraph are met, see section 10.5.1). IFRS 15 provides other practical expedients. Entities need to carefully consider the disclosure requirements of any other practical expedients it uses.

10.6 Disclosures in interim financial statements

IAS 34 requires disclosure of disaggregated revenue information, consistent with the requirement included in IFRS 15 for annual financial statements.[446] See section 10.5.1 for further discussion on this disclosure requirement.

Although none of the other annual IFRS 15 disclosure requirements apply to condensed interim financial statements, entities need to comply with the general requirements in IAS 34. For example, an entity is required to include sufficient information to explain events and transactions that are significant to an understanding of the changes in the entity's financial position and performance since the end of the last annual reporting period.[447] Information disclosed in relation to those events and transactions must update the relevant information presented in the most recent annual financial report. IAS 34 includes a non-exhaustive list of events and transactions for which disclosure would be required if they are significant, and which includes recognition of impairment losses on assets arising from contracts with customers, or reversals of such impairment losses.[448]

FASB differences

The required interim disclosures differ under IFRS and US GAAP.

While the IASB requires only disaggregated revenue information to be disclosed for interim financial statements, the FASB requires the quantitative disclosures about revenue required for annual financial statements to also be disclosed in interim financial statements.

[446] IAS 34.16A(l).
[447] IAS 34.15.
[448] IAS 34.15B.

Appendix A: Extract from EY's IFRS Disclosure Checklist

		Disclosure made		
		Yes	No	N/A
	IFRS 15 *Revenue from Contracts with Customers*			
	IFRS 15 *Revenue from Contracts with Customers* applies with limited exceptions to all contracts with customers.			
	Presentation			
IFRS 15.105	Does the entity present any unconditional rights to consideration separately from contract assets as a receivable	☐	☐	☐
IFRS 15.108	A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future. An entity must account for a receivable in accordance with IFRS 9.			
IFRS 15.108	Upon initial recognition of a receivable from a contract with a customer, does the entity present any difference between the measurement of the receivable in accordance with IFRS 9 and the corresponding amount of revenue as an expense (for example, as an impairment loss)	☐	☐	☐
IFRS 15.107	If the entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, does the entity present the contract as a contract asset, excluding any amounts presented as a receivable	☐	☐	☐
IFRS 15.107	A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer. An entity must assess a contract asset for impairment in accordance with IFRS 9. An impairment of a contract asset shall be measured, presented and disclosed on the same basis as a financial asset that is within the scope of IFRS 9 - see also paragraph IFRS15.113(b).			
IFRS 15.106	If a customer pays consideration, or the entity has a right to an amount of consideration that is unconditional (i.e., a receivable), before the entity transfers a good or service to the customer, does the entity present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier)	☐	☐	☐
IFRS 15.106	A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer.			
IFRS 15.109	If the entity uses an alternative description for a contract asset, does the entity provide sufficient information for a user of the financial statements to distinguish between receivables and contract assets	☐	☐	☐
IFRS 15.109	IFRS 15 uses the terms 'contract asset' and 'contract liability' but does not prohibit an entity from using alternative descriptions in the statement of financial position for those items.			
	The existence of a significant financing component in the contract			
IFRS 15.65	Does the entity present the effects of financing (interest revenue or interest expense) separately from revenue from contracts with customers in the statement of comprehensive income	☐	☐	☐
IFRS 15.65	Interest revenue or interest expense is recognised only to the extent that a contract asset (or receivable) or a contract liability is recognised in accounting for a contract with a customer.			

		Disclosure made		
		Yes	No	N/A
	Sale with a right of return			
IFRS 15.B25	Does the entity present the asset for an entity's right to recover products from a customer on settling a refund liability separately from the refund liability	☐	☐	☐
IFRS 15.B25	An asset recognised for an entity's right to recover products from a customer on settling a refund liability shall initially be measured by reference to the former carrying amount of the product (for example, inventory) less any expected costs to recover those products (including potential decreases in the value to the entity of returned products). At the end of each reporting period, an entity must update the measurement of the asset arising from changes in expectations about products to be returned.			
	Disclosures			
IFRS 15.110	The objective of the disclosure requirements in IFRS 15 is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.			
IFRS 15.111	An entity must consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. An entity must 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 substantially different characteristics.			
IFRS 15.112	An entity need not disclose information in accordance with IFRS 15 if it has provided the information in accordance with another standard.			
IFRS 15.110	To achieve the disclosure objective stated in IFRS 15.110, does the entity disclose qualitative and quantitative information about all of the following:			
	a. Its contracts with customers (see IFRS 15.113-122)	☐	☐	☐
	b. The significant judgements, and changes in the judgements, made in applying IFRS 15 to those contracts (see IFRS 15.123-126)	☐	☐	☐
	c. Any assets recognised from the costs to obtain or fulfil a contract with a customer in accordance with IFRS 15.91 or IFRS 15.95 (see IFRS15.127-128)	☐	☐	☐
	Contracts with customers			
IFRS 15.113	Does the entity disclose all of the following amounts for the reporting period unless those amounts are presented separately in the statement of comprehensive income in accordance with other standards:			
	a. Revenue recognised from contracts with customers, which the entity must disclose separately from its other sources of revenue	☐	☐	☐
	b. Any impairment losses recognised (in accordance with IFRS 9) on any receivables or contract assets arising from the entity's contracts with customers, which the entity must disclose separately from impairment losses from other contracts	☐	☐	☐

		Disclosure made		
		Yes	No	N/A
	Disaggregation of revenue			
IFRS 15.114	Does the entity disaggregate revenue recognised from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors	☐	☐	☐
IFRS 15.B87	IFRS 15.114 requires an entity to disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Consequently, the extent to which an entity's revenue is disaggregated for the purposes of this disclosure depends on the facts and circumstances that pertain to the entity's contracts with customers. Some entities may need to use more than one type of category to meet the objective in IFRS 15.114 for disaggregating revenue. Other entities may meet the objective by using only one type of category to disaggregate revenue.			
IFRS 15.B88	When selecting the type of category (or categories) to use to disaggregate revenue, an entity must consider how information about the entity's revenue has been presented for other purposes, including all of the following: a. Disclosures presented outside the financial statements (for example, in earnings releases, annual reports or investor presentations) b. Information regularly reviewed by the chief operating decision maker for evaluating the financial performance of operating segments c. Other information that is similar to the types of information identified in IFRS 15.B88(a) and (b) and that is used by the entity or users of the entity's financial statements to evaluate the entity's financial performance or make resource allocation decisions			
IFRS 15.B89	Examples of categories that might be appropriate include, but are not limited to, all of the following: ▸ Type of good or service (for example, major product lines) ▸ Geographical region (for example, country or region) ▸ Market or type of customer (for example, government and non-government customers) ▸ Type of contract (for example, fixed-price and time-and-materials contracts) ▸ Contract duration (for example, short-term and long-term contracts) ▸ Timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time) ▸ Sales channels (for example, goods sold directly to consumers and goods sold through intermediaries)			
IFRS 15.115	If the entity applies IFRS 8, does the entity disclose sufficient information to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue (in accordance with IFRS 15.114) and revenue information that is disclosed for each reportable segment	☐	☐	☐
	Contract balances			
IFRS 15.116	Does the entity disclose all of the following:			
	a. The opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed	☐	☐	☐
	b. Revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period	☐	☐	☐
	c. Revenue recognised in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (for example, changes in transaction price)	☐	☐	☐

		Disclosure made		
		Yes	No	N/A
IFRS 15.117 *IFRS 15.119*	Does the entity explain how the timing of satisfaction of its performance obligations (see IFRS 15.119(a)) relates to the typical timing of payment (see IFRS 15.119(b)) and the effect that those factors have on the contract asset and contract liability balances; the explanation provided may use qualitative information	☐	☐	☐
IFRS 15.118	Does the entity provide an explanation (with both qualitative and quantitative information) of the significant changes in the contract asset and the contract liability balances during the reporting period	☐	☐	☐
IFRS 15.118	Examples of changes in the entity's balances of contract assets and contract liabilities include any of the following: a. Changes due to business combinations b. Cumulative catch-up adjustments to revenue that affect the corresponding contract asset or contract liability, including adjustments arising from a change in the measure of progress, a change in an estimate of the transaction price (including any changes in the assessment of whether an estimate of variable consideration is constrained) or a contract modification c. Impairment of a contract asset d. A change in the time frame for a right to consideration to become unconditional (ie for a contract asset to be reclassified to a receivable) e. A change in the time frame for a performance obligation to be satisfied (i.e., for the recognition of revenue arising from a contract liability)			
	Performance obligations			
IFRS 15.119	Does the entity disclose information about its performance obligations in contracts with customers, including a description of all of the following:			
	a. When the entity typically satisfies its performance obligations (for example, upon shipment, upon delivery, as services are rendered or upon completion of service), including when performance obligations are satisfied in a bill-and-hold arrangement	☐	☐	☐
	b. The significant payment terms	☐	☐	☐
IFRS 15.119	For example, when payment is typically due, whether the contract has a significant financing component, whether the consideration amount is variable and whether the estimate of variable consideration is typically constrained in accordance with IFRS 15.56–58.			
	c. The nature of the goods or services that the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (i.e., if the entity is acting as an agent)	☐	☐	☐
	d. Obligations for returns, refunds and other similar obligations	☐	☐	☐
	e. Types of warranties and related obligations	☐	☐	☐

		Disclosure made		
		Yes	No	N/A
	Transaction price allocated to the remaining performance obligations			
IFRS 15.120	Does the entity disclose all of the following information about its remaining performance obligations:			
	a. The aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period	☐	☐	☐
	b. An explanation of when the entity expects to recognise as revenue the amount disclosed in accordance with IFRS 15.120(a), which the entity discloses in either of the following ways:	☐	☐	☐
	▸ On a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations	☐	☐	☐
	▸ By using qualitative information	☐	☐	☐
IFRS 15.121	As a practical expedient, an entity need not disclose the information in IFRS 15.120 for a performance obligation if either of the following conditions is met: a. The performance obligation is part of a contract that has an original expected duration of one year or less Or b. The entity recognises revenue from the satisfaction of the performance obligation in accordance with IFRS 15.B16. That is, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), as a practical expedient, the entity may recognise revenue in the amount to which the entity has a right to invoice.			
IFRS 15.B16				
IFRS 15.122	Does the entity explain qualitatively whether it is applying the practical expedient in IFRS 15.121 and whether any consideration from contracts with customers is not included in the transaction price and, therefore, not included in the information disclosed in accordance with IFRS 15.120	☐	☐	☐
	Significant judgements in the application of IFRS 15			
IFRS 15.123	Does the entity disclose the judgements, and changes in the judgements, made in applying IFRS 15 that significantly affect the determination of the amount and timing of revenue from contracts with customers. In particular, does the entity explain the judgements, and changes in the judgements, used in determining both of the following:			
	a. The timing of satisfaction of performance obligations (see IFRS 15.124-125)	☐	☐	☐
	b. The transaction price and the amounts allocated to performance obligations (see IFRS 15.126)	☐	☐	☐

		Disclosure made		
		Yes	No	N/A
	Determining the timing of satisfaction of performance obligations			
IFRS 15.124	For performance obligations that the entity satisfies over time, does the entity disclose both of the following:			
	a. The methods used to recognise revenue (for example, a description of the output methods or input methods used and how those methods are applied)	☐	☐	☐
	b. An explanation of why the methods used provide a faithful depiction of the transfer of goods or services	☐	☐	☐
IFRS 15.125	For performance obligations satisfied at a point in time, does the entity disclose the significant judgements made in evaluating when a customer obtains control of promised goods or services	☐	☐	☐
	Determining the transaction price and the amounts allocated to performance obligations			
IFRS 15.126	Does the entity disclose information about the methods, inputs and assumptions used for all of the following:			
	a. Determining the transaction price, which includes, but is not limited to, estimating variable consideration, adjusting the consideration for the effects of the time value of money and measuring non-cash consideration	☐	☐	☐
	b. Assessing whether an estimate of variable consideration is constrained	☐	☐	☐
	c. Allocating the transaction price, including:	☐	☐	☐
	▸ Estimating stand-alone selling prices of promised goods or services	☐	☐	☐
	▸ Allocating discounts to a specific part of the contract (if applicable)	☐	☐	☐
	▸ Allocating variable consideration to a specific part of the contract (if applicable)	☐	☐	☐
	d. Measuring obligations for returns, refunds and other similar obligations	☐	☐	☐
	Assets recognised from the costs to obtain or fulfil a contract with a customer			
IFRS 15.127	Does the entity describe both of the following:			
	a. The judgements made in determining the amount of the costs incurred to obtain or fulfil a contract with a customer	☐	☐	☐
	b. The method it uses to determine the amortisation for each reporting period	☐	☐	☐
IFRS 15.128	Does the entity disclose all of the following:			
	a. The closing balances of assets recognised from the costs incurred to obtain or fulfil a contract with a customer (in accordance with IFRS 15.91 or IFRS 15.95), by main category of asset (for example, costs to obtain contracts with customers, pre-contract costs and setup costs)	☐	☐	☐
	b. The amount of amortisation recognised in the reporting period	☐	☐	☐
	c. The amount of any impairment losses recognised in the reporting period	☐	☐	☐

		Disclosure made		
		Yes	No	N/A
	Practical expedients			
IFRS 15.129	If the entity elects to use the practical expedient in IFRS15.63 regarding the existence of a significant financing component, does the entity disclose that fact	☐	☐	☐
IFRS 15.63	As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.			
IFRS 15.129	If the entity elects to use the practical expedient in IFRS15.94 regarding the incremental costs of obtaining a contract, does the entity disclose that fact	☐	☐	☐
IFRS 15.94	As a practical expedient, an entity may recognise the incremental costs of obtaining a contract as an expense when incurred if the amortisation period of the asset that the entity otherwise would have recognised is one year or less.			
	Statement of profit or loss and other comprehensive income			
IAS 1.32	Unless required or permitted by another IFRS, does the entity present separately, and not offset, income and expenses	☐	☐	☐
IAS 1.34	Examples of items that are or may be offset in the statement of comprehensive income include the following: a. Gains and losses on the disposal of non-current assets, including investments and operating assets, are reported by deducting from the proceeds (or the amount of consideration when an entity applies IFRS 15 early) on disposal the carrying amount of the asset and related selling expenses b. Expenditure related to a provision that is recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and reimbursed under a contractual arrangement with a third party (for example, a supplier's warranty agreement) may be netted against the related reimbursement. c. Gains and losses arising from a group of similar transactions are reported on a net basis, for example, foreign exchange gains and losses or gains and losses arising on financial instruments held for trading. However, an entity presents such gains and losses separately if they are material.			
IAS 1.35				
	Condensed interim reporting			
	Explanatory notes			
IAS 34.16A	Does the entity disclose the following information in the notes to its interim financial statements or elsewhere in the interim financial report (the information is normally reported on a financial year-to-date basis):	☐	☐	☐
	The following disclosures shall be given either in the interim financial statements or incorporated by cross-reference from the interim financial statements to some other statement (such as management commentary or risk report) that is available to users of the financial statements on the same terms as the interim financial statements and at the same time. If users of the financial statements do not have access to the information incorporated by cross-reference on the same terms and at the same time, the interim financial report is incomplete.			
	…			
	l. The disaggregation of revenue from contracts with customers required by IFRS 15.114-115	☐	☐	☐

Appendix B: Illustrative examples included in the standard and references in this publication

Identifying the contract		
Example 1	Collectability of the consideration	Section 3.1.5
Example 2	Consideration is not the stated price — implicit price concession	Section 5.2.1.A
Example 3	Implicit price concession	Not included
Example 4	Reassessing the criteria for identifying a contract	Not Included
Contract modifications		
Example 5	Modification of a contract for goods	
	Case A—Additional products for a price that reflects the stand-alone selling price	Section 3.4.1
	Case B—Additional products for a price that does not reflect the stand-alone selling price	Section 3.4.2
Example 6	Change in the transaction price after a contract modification	Not Included
Example 7	Modification of a services contract	Not Included
Example 8	Modification resulting in a cumulative catch-up adjustment to revenue	Section 3.4.2
Example 9	Unapproved change in scope and price	Section 3.4
Identifying performance obligations		
Example 10	Goods and services are not distinct	
	Case A—Significant integration service	Section 4.2.3
	Case B—Significant integration service	Section 4.2.3
Example 11	Determining whether goods or services are distinct	
	Case A—Distinct goods or services	Section 4.2.3
	Case B—Significant customisation	Section 4.2.3
	Case C—Promises are separately identifiable (installation)	Section 4.2.3
	Case D—Promises are separately identifiable (contractual restrictions)	Section 4.2.3
	Case E—Promises are separately identifiable (consumables)	Section 4.2.3
Example 12	Explicit and implicit promises in a contract	
	Case A—Explicit promise of service	Section 4.1
	Case B—Implicit promise of service	Section 4.1
	Case C—Services are not a promised service	Section 4.1
Performance obligations satisfied over time		
Example 13	Customer simultaneously receives and consumes the benefits	Section 7.1.1
Example 14	Assessing alternative use and right to payment	Section 7.1.3
Example 15	Asset has no alternative use to the entity	Section 7.1.3
Example 16	Enforceable right to payment for performance completed to date	Section 7.1.3

Example 17	Assessing whether a performance obligation is satisfied at a point in time or over time	
	Case A—Entity does not have an enforceable right to payment for performance completed to date	Section 7.1.3
	Case B—Entity has an enforceable right to payment for performance completed to date	Section 7.1.3
	Case C—Entity has an enforceable right to payment for performance completed to date	Section 7.1.3
Measuring progress toward complete satisfaction of a performance obligation		
Example 18	Measuring progress when making goods or services available	Section 7.1.4.C
Example 19	Uninstalled materials	Section 7.1.4.B
Variable consideration		
Example 20	Penalty gives rise to variable consideration	Not Included
Example 21	Estimating variable consideration	Not Included
Constraining estimates of variable consideration		
Example 22	Right of return	Section 5.4
Example 23	Price concessions	
	Case A—Estimate of variable consideration is not constrained	Section 5.2.3
	Case B—Estimate of variable consideration is constrained	Section 5.2.3
Example 24	Volume discount incentive	Section 5.2.1
Example 25	Management fees subject to the constraint	Not Included
The existence of a significant financing component in the contract		
Example 26	Significant financing component and right of return	Section 5.5.1
Example 27	Withheld payments on a long-term contract	Section 5.5.1
Example 28	Determining the discount rate	
	Case A—Contractual discount rate reflects the rate in a separate financing transaction	Section 5.5.1
	Case B—Contractual discount rate does not reflect the rate in a separate financing transaction	Section 5.5.1
Example 29	Advance payment and assessment of the discount rate	Section 5.5.1
Example 30	Advance payment	Section 5.5.1
Non-cash consideration		
Example 31	Entitlement to non-cash consideration	Section 5.6
Consideration payable to a customer		
Example 32	Consideration payable to a customer	Section 5.7.3

Allocating the transaction price to performance obligations		
Example 33	Allocation methodology	Section 6.1.2
Example 34	Allocating a discount	
	Case A—Allocating a discount to one or more performance obligations	Section 6.4
	Case B—Residual approach is appropriate	Section 6.4
	Case C—Residual approach is inappropriate	Section 6.4
Example 35	Allocation of variable consideration	
	Case A—Variable consideration allocated entirely to one performance obligation	Sections 6.3
	Case B—Variable consideration allocated on the basis of stand-alone selling prices	Sections 6.3
Contract costs		
Example 36	Incremental costs of obtaining a contract	Section 9.3.1
Example 37	Costs that give rise to an asset	Section 9.3.2
Presentation		
Example 38	Contract liability and receivable	
	Case A—Cancellable contract	Section 10.1
	Case B—Non-cancellable contract	Section 10.1
Example 39	Contract asset recognised for the entity's performance	Section 10.1
Example 40	Receivable recognised for entity's performance	Not Included
Disclosure		
Example 41	Disaggregation of revenue — quantitatve disclosure	Section 10.5.1
Example 42	Disclosure of the transaction price allocated to the remaining performance obligations	Section 10.5.1
Example 43	Disclosure of the transaction price allocated to the remaining performance obligations — qualitative disclosure	Section 10.5.1
Warranties		
Example 44	Warranties	Not Included
Principal versus agent considerations		
Example 45	Arranging for the provision of goods or services (entity is an agent)	Not Included
Example 46	Promise to provide goods or services (entity is a principal)	Not Included
Example 46A	Promise to provide goods or services (entity is a principal)	Section 4.4.4
Example 47	Promise to provide goods or services (entity is a principal)	Section 4.4.4
Example 48	Arranging for the provision of goods or services (entity is an agent)	Section 4.4.4
Example 48A	Entity is a principal and an agent in the same contract	Not Included
Customer options for additional goods or services		
Example 49	Option that provides the customer with a material right (discount voucher)	Section 4.6
Example 50	Option that does not provide the customer with a material right (additional goods or services)	Not Included
Example 51	Option that provides the customer with a material right (renewal option)	Not Included

Example 52	Customer loyalty programme	Section 7.9
Non-refundable upfront fees		
Example 53	Non-refundable upfront fee	Not Included
Licensing		
Example 54	Right to use intellectual property	Not Included
Example 55	Licence of intellectual property	Not Included
Example 56	Identifying a distinct licence	
	Case A—Licence is not distinct	Sections 8.2.1
	Case B—Licence is distinct	Sections 8.1.1
Example 57	Franchise rights	Not Included
Example 58	Access to intellectual property	Section 8.3.1
Example 59	Right to use intellectual property	Section 8.3.2
Example 60	Access to intellectual property	Section 8.5
Example 61	Access to intellectual property	Section 8.5.1
Repurchase arrangements		
Example 62	Repurchase agreements	
	Case A—Call option: financing	Sections 7.3.1
	Case B—Put option: lease	Sections 7.3.2
Bill-and-hold arrangements		
Example 63	Bill-and-hold arrangement	Section 7.5

Appendix C: TRG discussions and references in this publication

This appendix includes topics discussed by the TRG and where they are discussed within this publication.

The FASB staff has compiled publicly available TRG memos and other educational resources previously issued on the implementation of the US GAAP revenue standard, ASC 606, into a document called *Revenue Recognition Implementation Q&As* (FASB staff Q&As). The staff's objective in compiling this material, which is organised by subject matter (e.g., step of the revenue model), was to make the available educational resources easier to navigate and not to issue any new application guidance.

Date of TRG meeting	Agenda paper no.	Topic discussed	Applying IFRS Section
18 July 2014	1	Gross versus net revenue	TRG discussions led to amendments to IFRS 15 that are discussed in sections 4.4 & 6.2
	2	Gross versus net revenue: amounts billed to customers	Section 4.4.4
	3	Sales-based and usage-based royalties in contracts with licences and goods or services other than licences	TRG discussions led to amendments to IFRS 15 that are discussed in section 8.5
	4	Impairment testing of capitalised contract costs	Section 9.3.4
31 October 2014	5	July 2014 meeting – summary of issues discussed and next steps	Not applicable
	6	Customer options for additional goods and services and non-refundable upfront fees	Section 4.6
	7	Presentation of a contract as a contract asset or a contract liability	Section 10.1
	8	Determining the nature of a licence of intellectual property	TRG discussions led to amendments to IFRS 15 that are discussed in section 8
	9	Distinct in the context of the contract	TRG discussions led to amendments to IFRS 15 that are discussed in section 4.2.1.B
	10	Contract enforceability and termination clauses	Section 3.2
26 January 2015	11	October 2014 meeting – summary of issues discussed and next steps	Not applicable
	12	Identifying promised goods or services	TRG discussions led to amendments to IFRS 15 that are discussed in section 4.1
	13	Collectability	Sections 3.1.5 & 5.2.1.A
	14	Variable consideration	Section 5.2.3
	15	Non-cash consideration	Section 5.6.1
	16	Stand-ready obligations	Section 7.1.4.C
	17	Islamic finance transactions	Section 2.5
	18	Material right	Questions in this paper were brought forward to agenda paper no. 32 for TRG discussion

Date of TRG meeting	Agenda paper no.	Topic discussed	Applying IFRS Section
	19	Consideration payable to a customer	Questions in this paper were brought forward to agenda paper no. 28 for TRG discussion
	20	Significant financing component	Questions in this paper were brought forward to agenda paper no. 30 for TRG discussion
	21	Licences research update	No TRG discussion — update only
	22	Performance obligations research update	No TRG discussion — update only
	23	Costs to obtain a contract	Sections 9.3.1 & 9.3.3
	24	Contract modifications	TRG discussions led to amendments to the transition requirements in IFRS 15 that are discussed in Appendix F
30 March 2015	25	January 2015 meeting — summary of issues discussed and next steps	Sections 3.1.5 & 4.1
	26	Contributions	Section 2.5
	27	Series of distinct goods or services	Section 4.2.2
	28	Consideration payable to a customer	Sections 5.7 & 5.7.1
	29	Warranties	Section 9.1.1
	30	Significant financing component	Sections 5.5 & 5.5.1
	31	Variable discounts	Section 6.4
	32	Exercise of material right	Sections 4.6 & 5.8
	33	Partially satisfied performance obligations	Sections 3.5, 7.1.4.C & 9.3.2
13 July 2015	34	March 2015 meeting — summary of issues discussed and next steps	Not applicable
	35	Accounting for restocking fees and related costs	Section 5.4
	36	Credit cards	Section 2.5
	37	Consideration payable to a customer	Sections 5.7, 5.7.1 & 5.7.3
	38	Portfolio practical expedient and application of variable consideration constraint	Sections 5.2.2, 5.2.3 & 5.4
	39	Application of the series provision and allocation of variable consideration	Sections 4.2.2, 5.2.1, 6.3 & 8.3.1
	40	Practical expedient for measuring progress toward complete satisfaction of a performance obligation	Sections 7.1.4.A, 7.1.4.C & 10.5.1
	41	Measuring progress when multiple goods or services are included in a single performance obligation	Section 7.1.4.C
	42	Completed contracts at transition	TRG discussions led to amendments to the transition requirements in IFRS 15 that are discussed in Appendix F
	43	Determining when control of a commodity transfers	Section 7.1.1

Date of TRG meeting	Agenda paper no.	Topic discussed	Applying IFRS Section
9 November 2015	44	July 2015 meeting — summary of issues discussed and next steps	Section 5.7.3 & 7.1.4.A
	45	Licences — specific application issues about restrictions and renewals	TRG discussions led to amendments to IFRS 15 that are discussed in sections 8.1.3 & 8.4
	46	Pre-production activities	Sections 4.1
	47	Whether fixed odds wagering contracts are included or excluded from the scope of the new standard	Section 2.5
	48	Customer options for additional goods and services	Sections 3.2, 4.1 & 4.6
	49	November 2015 meeting — summary of issues discussed and next steps	Not applicable
18 April 2016 (*FASB TRG meeting only*)	50	Scoping considerations for incentive-based capital allocations	Not included
	51	Contract asset treatment in contract modifications	Section 10.1
	52	Scoping considerations for financial institutions	Section 2.5
	53	Evaluating how control transfers over time	Section 7.1.4.C
	54	Class of customer	Section 4.6
	55	April 2016 Meeting — Summary of Issues Discussed and Next Steps	Not applicable
7 November 2016	56	Over Time Revenue Recognition	Section 7.1.3
	57	Capitalization and Amortization of Incremental Costs of Obtaining a Contract	Sections 9.3.1 & 9.3.3
	58	Sales-Based or Usage-Based Royalty with Minimum Guarantee	Section 8.5
	59	Payments to Customers	Section 5.7.3
	60	November 2016 Meeting — Summary of Issues Discussed and Next Steps	Not applicable

Appendix D: IFRS IC discussions and references in this publication (updated October 2020)

This appendix includes topics discussed by the IFRS IC that are discussed within this publication. Applicable standards referenced exclude any standards that were superseded at the time of writing.

Topic discussed (and applicable standards)	Date(s) discussed by IFRS IC	Agenda paper no.	Status at the time of writing	*IFRIC Update*	Applying IFRS Section
Presentation of Player Transfer Payments (IAS 38)	26 November 2019 16 June 2020	6 5	Final agenda decision	June 2020	Section 2.2.1 and Question 10-7 in Section 10.2
Sale of a Single Asset Entity Containing Real Estate (IFRS 10 and IFRS 15) / Sale of a Subsidiary to a Customer	11-12 June 2019 IASB discussion 23-25 June	6 12A	Issue referred for inclusion in the post-implementation review of IFRS 10.	June 2019 *IASB Update* June 2020	Question 2-11 in Section 2.5
Costs considered in assessing whether a contract is onerous (IAS 37)	12 June 2018 13 March 2018 20 November 2017 12 September 2017 13 June 2017	6 5 5 5D 4	On May 2020, the IASB issued an amendment *Onerous Contracts—Cost of Fulfilling a Contract (Amendments to IAS 37)*, which is effective for annual periods beginning on or after 1 January 2022.	N/A	Section 9.2
Training Costs to Fulfil a Contract (IFRS 15)	17 September 2019 3 March 2020	2 5	Final agenda decision	March 2020	Section 9.3.2 and Question 9-15 in Section 9.3.2
Compensation for Delays or Cancellations (IFRS 15)	17 September 2019 11-12 June 2019	6 8	Final agenda decision	September 2019	Question 5-4 in Section 5.2.1
Costs to Fulfil a Contract (IFRS 15)	11-12 June 2019 5-6 March 2019	10 2	Final agenda decision	June 2019	Section 9.3.2
Sale of Output by a Joint Operator (IFRS 11 and IFRS 15)	5-6 March 2019 27 November 2018	8 2	Final agenda decision	March 2019	Question 2-12 in Section 2.5
Over time transfer of constructed good (IAS 23 and IFRS 15)	5-6 March 2019 27 November 2018	3 4	Final agenda decision	March 2019	Question 5-25 in Section 5.5.1

Topic discussed (and applicable standards)	Date(s) discussed by IFRS IC	Agenda paper no.	Status at the time of writing	*IFRIC Update*	Applying IFRS Section
Assessment of promised goods or services (IFRS 15)	16 January 2019 11-12 September 2018	3 2	Final agenda decision	January 2019	Section 4.1
Revenue recognition in a real estate contract (IFRS 15)	13 March 2018 12 September 2017	2C 2	Final agenda decision	March 2018	Question 7-3 in Section 7.1.2, Question 7-10 in Section 7.1.3 and Section 7.2
Revenue recognition in a real estate contract that includes the transfer of land (IFRS 15)	13 March 2018 20 November 2017	2D 2A	Final agenda decision	March 2018	Section 4.2.1.B and Question 7-10 in Section 7.1.3
Right to payment for performance completed to date (IFRS 15)	13 March 2018 20 November 2017	2E 2B	Final agenda decision	March 2018	Questions 7-10 and 7-11 in Section 7.1.3
Classification of liability for a prepaid card in the issuer's financial statements (IAS 32 and IFRS 9)	22 March 2016 12 January 2016 8-9 September 2015 27 January 2015 11 November 2014	4 5 4 6 13	Final agenda decision	March 2016	Question 2-9 in Section 2.5
Gaming transactions (IAS 32)	12 July 2007 3-4 May 2007	7B 11(i)	Final agenda decision	July 2007	Question 2-6 in Section 2.5

Appendix E: Defined terms

Extract from IFRS 15

Appendix A Defined terms

This appendix is an integral part of the Standard.

contract	An agreement between two or more parties that creates enforceable rights and obligations.
contract asset	An entity's right to consideration in exchange for goods or services that the entity has transferred to a **customer** when that right is conditioned on something other than the passage of time (for example, the entity's future performance).
contract liability	An entity's obligation to transfer goods or services to a **customer** for which the entity has received consideration (or the amount is due) from the customer.
customer	A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.
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 an increase in equity, other than those relating to contributions from equity participants.
performance obligation	A promise in a **contract** with a **customer** to transfer to the customer either: (a) A good or service (or a bundle of goods or services) that is distinct; or (b) A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.
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 an entity would sell a promised good or service separately to a **customer**.
transaction price (for a contract with a customer)	The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a **customer**, excluding amounts collected on behalf of third parties.

Appendix F: Changes to the standard since issuance

Since the issuance of the standards, the Boards have issued various amendments to their respective standards, as summarised below. The Boards did not agree on the nature and breadth of all of the changes to their respective revenue standards. However, the Boards have said they expect the amendments to result in similar outcomes in many circumstances. No further changes to the standard are currently expected.

In September 2015, the IASB deferred the effective date of IFRS 15 by one year to give entities more time to implement it.[449] In addition, in April 2016, the IASB issued *Clarifications to IFRS 15 Revenue from Contracts with Customers* (the IASB's amendments) that addressed several implementation issues (many of which were discussed by the TRG) on key aspects of the standard.

The IASB's amendments:

- Clarified when a promised good or service is separately identifiable from other promises in a contract (i.e., distinct within the context of the contract), which is part of an entity's assessment of whether a promised good or service is a performance obligation (see section 4.2)
- Clarified how to apply the principal versus agent application guidance to determine whether the nature of an entity's promise is to provide a promised good or service itself (i.e., the entity is a principal) or to arrange for goods or services to be provided by another party (i.e., the entity is an agent) (see section 4.4)
- Clarified for a licence of intellectual property when an entity's activities significantly affect the intellectual property to which the customer has rights, which is a factor in determining whether the entity recognises revenue over time or at a point in time (see section 8)
- Clarified the scope of the exception for sales-based and usage-based royalties related to licences of intellectual property (the royalty recognition constraint) when there are other promised goods or services in the contract (see section 8.5)
- Added two practical expedients to the transition requirements of IFRS 15 for: (a) completed contracts under the full retrospective transition method; and (b) contract modifications at transition

The FASB also deferred the effective date of its standard by one year for US GAAP public and non-public entities, as defined, which kept the standards' effective dates converged under IFRS and US GAAP. However, as discussed in section 2.1, in June 2020, the FASB deferred by one year the effective date for entities that had not yet issued financial statements or made financial statements available for issuance that reflected the standard as of 3 June 2020 (i.e., certain non-public and not-for-profit entities).

Like the IASB, the FASB also amended its revenue standard to address principal versus agent considerations, identifying performance obligations, licences of intellectual property and certain practical expedients on transition. The FASB's amendments for principal versus agent considerations and clarifying when a promised good or service is separately identifiable when identifying performance obligations were converged with those of the IASB discussed above. However, the FASB's other amendments were not the same as those of the IASB. The FASB also issued amendments, which the IASB did not, relating to immaterial goods or services in a contract, accounting for shipping and handling, collectability, non-cash consideration, consideration payable to a customer, the presentation of sales and other similar taxes, the measurement and recognition of gains and losses on the sale of non-financial assets (e.g., property, plant and equipment) and other technical corrections.[450] We describe the significant differences between the IASB's final standard and the FASB's final standard throughout this publication.

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[449] *Effective Date of IFRS 15,* issued by the IASB in September 2015.

[450] The FASB's amendments to its standard were effected through the following: ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*; ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*; ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing* (April 2016); ASU 2016-12, *Revenue from Contracts with Customer (Topic 606): Narrow-Scope Improvements and Practical Expedients* (May 2016)*;* and ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue From Contracts With Customers* (December 2016)

Appendix G: Summary of important changes to this publication

We have made important changes to this publication since the September 2019 edition, to address evolving implementation issues and expand our discussion of certain topics. The list below summarises the most significant changes we made in our October 2020 update.

Section 1 **Overview of the standard**

- Removed from the title and the content of section 1 any discussions on the effective date and the transition requirements to IFRS 15
- Removed sections 1.2 and 1.3 that discussed the effective date and transition methods of IFRS 15

Section 2 **Scope**

- Updated discussion in section 2.1 on IFRS 15 scoping challenges
- Updated section 2.1.1 to refer to the IFRS IC's recent agenda decision on player transfer payments
- Updated Question 2-11 in section 2.5 on the scope considerations for the sale of corporate wrappers to customers
- Added Question 2-13 in section 2.5 on scoping considerations for transactions involving the issuance of equity instruments by an entity to a customer in connection with a revenue arrangement

Section 3 **Identify the contract with the customer**

- Expanded our discussion in section 3.1.5 on assessing collectability under IFRS 15, including the interaction with IFRS 9
- Added Question 3-10 in section 3.2 on how to account for consideration received from a customer, but not yet recognised as revenue, when the contract is cancelled
- Added Questions 3-15 and 3-16 in section 3.4 on how to distinguish between contract modifications and changes of estimates of variable consideration after contract inception and marketing offers, respectively
- Updated discussion in section 3.4.2 to refer to Example 7 in the standard, which illustrates the accounting for a modification of a contract that is determined to be a series of distinct goods or services
- Added Question 3-21 and Illustration 3-8 in section 3.4.2 on how to account for a 'blend-and-extend' contract modification

Section 4 **Identify the performance obligations in the contract**

- Combined sections 4.1 and 4.1.1
- Added Question 4-4 in section 4.1 on how consider exclusivity provisions when identifying promised goods or services in a contract
- Updated section 4.2.1.B to reference an SEC staff speech on determining whether a promise to transfer a good or service to a customer is separately identifiable from other promises in the contract
- Added Question 4-5 and Illustration 4-2 in section 4.2.1.B on determining whether 'connected' hardware sold with cloud services represent one or more performance obligations
- Added Question 4-6 and Illustrations 4-3 & 4-4 in section 4.2.1.B on determining whether implementation services are distinct

- Added an example to Question 4-8 in section 4.2.2 in which the accounting result would be different if a performance obligation is not accounted for as a series
- Added Question 4-11 in section 4.2.2 on whether all stand-ready obligations meet the criteria to be accounted for as a series
- Added Illustration 4-6 in section 4.4.1 in which an entity is a principal for some specified goods or services and an agent for others
- Updated section 4.4.2 to reference an SEC staff speech that discussed a principal versus agent consultation
- Added Illustration 4-11 to Question 4-17 in section 4.6 in which the contract includes a customer option that is determined to be a material right
- Added Illustration 4-12 to Question 4-21 in section 4.6 on evaluating a customer option with volume discounts
- Added Question 4-22 in section 4.6 on how to consider whether a renewal option is a material right
- Added Question 4-23 in section 4.6 on how to consider whether a loyalty or reward programme is a material right

Section 5 **Determine the transaction price**

- Expanded our discussion in section 5.2.1.A to include factors that may suggest an entity has implicitly offered a price concession to a customer at contract inception (including how to consider variable consideration versus credit risk at contract inception) and to discuss how to consider changes in expectations about the amount an entity expects to collect after contract inception
- Updated section 5.2.4 to discuss the applicability of the subsequent event requirements in IAS 10 to changes in estimates of variable consideration
- Updated section 5.5 to reference an SEC staff speech on a significant financing component consultation involving a large upfront payment
- Added section 5.6.2 on barter transactions
- Reordered sections 5.7.1 and 5.7.2 on consideration payable to a customer
- Added Question 5-33 in section 5.8 on how to account for consideration that was received from a customer, but not yet recognised as revenue, when the contract is cancelled

Section 6 **Allocate the transaction price to the performance obligations**

- Expanded our discussion in section 6.3 on the variable consideration allocation exception and added Illustrations 6-5 and 6.6 on considerations for contracts with usage-based variable consideration
- Updated section 6.5 to discuss the applicability of the subsequent event requirements in IAS 10 to changes in estimates of variable consideration

Section 7 **Satisfaction of performance obligations**

- Removed Question 7-1 in section 7.1 that discussed whether an entity that recognised revenue at a point in time under legacy standards can recognise revenue over time under IFRS 15
- Updated our discussion in section 7.1.4 on updating the measure of progress for over-time performance obligations

- Updated section 7.1.4.B to reference an SEC staff speech on the applicability of the uninstalled materials application guidance to fact patterns beyond construction-type goods
- Updated Question 7.12 in section 7.1.4.C on revenue recognition for stand-ready obligations that are satisfied over time
- Updated Question 7-14 in section 7.1.4.C to add example on determining the single appropriate measure of progress for a combined performance obligation satisfied over time
- Updated Question 7-18 in section 7.1.4.C on how to measure progress for contracts acquired in a business combination that have remaining performance obligations to be satisfied over time

Section 8 **Licences of intellectual property**

- Added Question 8-2 in section 8.1.4 on contracts that grant both permission for past use of intellectual property and a licence to use the intellectual property in the future
- Updated section 8.3.1 to note that a right-to-access licence will often meet the criteria to be recognised over time
- Updated our discussion in section 8.5 on the applicability of the variable consideration requirements to sales-based or usage-based royalties related to licences of intellectual property
- Added Question 8-6 and Illustration 8-2 in section 8.5.1 on whether the royalty recognition constraint can be applied when there is a milestone payment based on the first commercial sale
- Added Question 8-12 in section 8.5.1 on whether the royalty recognition constraint can be applied when the royalty is calculated on a financial metric that is not solely based on sales or usage

Section 9 **Other measurement and recognition topics**

- Updated section 9.2 for the recent IAS 37 amendment issued by the IASB on onerous contracts
- Updated section 9.3.2 on the IFRS IC's discussion on costs to fulfil a contract related to past performance that must be expensed
- Added Question 9-18 and Illustrations 9-4 & 9-5 in section 9.3.2 on accounting for costs associated with installation or implementation services
- Added a graphic in section 9.3.3 on factors to consider when evaluating the period of benefit of capitalised contract costs

Section 10 **Presentation and disclosure**

- Added a flowchart in section 10.1 to illustrate how an entity determines whether to recognise a receivable, a contract asset or a contract liability on the balance sheet
- Added Illustration 10-1 in section 10.1 on unbilled receivable
- Added discussion in section 10.1 on derecognition of contract assets
- Added Illustration 10-2 in Question 10-1 in section 10.1 on presentation of contract assets and liabilities for contracts that contain multiple performance obligations
- Added an example to Question 10-5 in section 10.1 on the accounting for an existing contract asset when the contract is modified

- Updated Question 10-7 in section 10.2 to refer to the IFRS IC's recent agenda decision on player transfer payments and expand our discussion on an entity's ordinary activities
- Removed section 10.6 that had discussed transition disclosure requirements

Appendix H **Summary of differences from US GAAP**

- Removed this appendix, which provided a comparison of the IFRS and US GAAP standards that was issued by the IASB and is included as an appendix to the Basis for Conclusions on IFRS 15. It is reproduced in its entirety. The FASB has subsequently made changes to its revenue standard (most significantly in ASU 2016-20). However, the IASB did not make corresponding changes and had not updated this summary. As such, this summary was not inclusive of any changes made to ASC 606 after ASU 2016-12.

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EYG no. 007005-20Gbl
EY-000125617.indd (UK) 10/20.
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