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Exposure Draft ED/2010/6

Revenue from Contracts with Customers

Comments to be received by 22 October 2010

International
Accounting Standards
Board®

Exposure Draft

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

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

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Introduction and questions for respondents

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

IN1 Revenue is a crucial number to users of financial statements in assessing a company's performance and prospects. However, revenue recognition requirements in US generally accepted accounting principles (GAAP) differ from those in International Financial Reporting Standards (IFRSs), and both sets of requirements are considered to be in need of improvement. US GAAP comprises broad revenue recognition concepts and numerous requirements for particular industries or transactions that can result in different accounting for economically similar transactions. Although IFRSs provide less guidance on revenue recognition, the two main revenue recognition standards, IAS 18 *Revenue* and IAS 11 *Construction Contracts*, can be difficult to understand and apply to transactions beyond simple transactions. In addition, those standards have limited guidance on important topics such as revenue recognition for multiple-element arrangements.

IN2 Accordingly, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) initiated a joint project to clarify the principles for recognising revenue and to develop a common revenue standard for IFRSs and US GAAP that would:

(a) remove inconsistencies and weaknesses in existing revenue recognition standards and practices;

(b) provide a more robust framework for addressing revenue recognition issues;

(c) improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets; and

(d) simplify the preparation of financial statements by reducing the number of requirements to which entities must refer.

IN3 To meet those objectives, the IASB and the FASB have jointly developed a draft standard on revenue and, hence, are proposing amendments to IFRSs and to the *FASB Accounting Standards Codification*™ (ASC).

Who would be affected by the proposals?

IN4 The proposed requirements would affect any entity that enters into contracts to provide goods or services that are an output of the entity's ordinary activities, unless those contracts are within the scope of other IFRSs or other requirements of US GAAP.

IN5 In IFRSs, the proposed requirements would supersede IAS 18 and IAS 11 and related Interpretations. In US GAAP, the proposed requirements would supersede most of the requirements on revenue recognition in ASC Topic 605.

IN6 In addition, the existing requirements for the recognition of a gain or loss on the sale of some non-financial assets that are not an output of the entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 *Property, Plant and Equipment* or IAS 40 *Investment Property* or ASC Topic 360) would be amended to be consistent with the proposed revenue recognition and measurement requirements.

IN7 Appendix C contains additional information on proposed consequential amendments to other IFRSs.

What are the main proposals?

IN8 The proposed requirements specify the principles that an entity would apply to report useful information about the amount, timing and uncertainty of revenue and cash flows arising from its contracts to provide goods or services to customers. In summary, the core principle would require an entity to recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it receives, or expects to receive, in exchange for those goods or services.

IN9 To apply that principle, an entity would:

(a) identify the contract(s) with a customer;

(b) identify the separate performance obligations in the contract;

(c) determine the transaction price;

(d) allocate the transaction price to the separate performance obligations; and

(e) recognise revenue when the entity satisfies each performance obligation.

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

(a) relate directly to a contract (or a specific contract under negotiation);

(b) generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and

(c) are expected to be recovered.

Identify the contract(s) with a customer

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

Identify the separate performance obligations in the contract

IN12 A performance obligation is an enforceable promise (whether explicit or implicit) in a contract with a customer to transfer a good or service to the customer.

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

IN14 A good or service is distinct if either:

(a) the entity, or another entity, sells an identical or similar good or service separately; or

(b) the entity could sell the good or service separately because the good or service has a distinct function and a distinct profit margin.

Determine the transaction price

IN15 The transaction price is the amount of consideration that an entity receives, or expects to receive, from a customer in exchange for transferring goods or services promised in the contract. In many contracts, the transaction price is readily determinable because the customer promises to pay a fixed amount of consideration and that payment is made at or near the time of the transfer of the promised goods or services.

IN16 If the amount of consideration is variable (for instance, because of rebates, bonuses, penalties or the customer's credit risk), an entity would recognise revenue from satisfying a performance obligation if the transaction price can be reasonably estimated. The transaction price can be reasonably estimated only if both of the following conditions are met:

(a) the entity has experience with similar types of contracts (or access to the experience of other entities if it has no experience of its own); and

(b) the entity's experience is relevant to the contract because the entity does not expect significant changes in circumstances.

IN17 When determining the transaction price, an entity would consider the effects of the following:

(a) collectibility;

(b) the time value of money;

(c) non-cash consideration; and

(d) consideration payable to the customer.

Allocate the transaction price to the separate performance obligations

IN18 An entity would allocate the transaction price to all separate performance obligations in proportion to the stand-alone selling prices of the goods or services underlying each of those performance obligations at contract inception. If a stand-alone selling price is not directly observable, the entity would estimate it.

IN19 The entity would update the transaction price over the life of the contract to reflect changes in circumstances and allocate changes in the transaction price to the separate performance obligations (see paragraph IN22).

Recognise revenue when a performance obligation is satisfied

IN20 An entity would recognise revenue when it satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service.

IN21 A customer obtains control of a good or service when the customer has the ability to direct the use of, and receive the benefit from, the good or service. The proposed requirements include indicators to assist an entity in determining when a customer has obtained control of a good or service.

IN22 When an entity satisfies a performance obligation, an entity would recognise revenue in the amount of the transaction price allocated to the satisfied performance obligation. If the transaction price changes after contract inception, the amount of the change allocated to performance obligations already satisfied at the time the transaction price changes would be recognised as revenue in the period in which the transaction price changes.

IN23 When the promised goods or services underlying a separate performance obligation are transferred to a customer continuously, an entity would apply to that performance obligation one revenue recognition method that best depicts the transfer of goods or services to the customer. Acceptable methods include methods based on an entity's outputs or inputs and methods based on the passage of time.

How would the proposals affect IFRSs and US GAAP?

IN24 The boards envisage that the accounting for revenue (and some costs) arising from contracts within the scope of the proposed requirements would be the same in both IFRSs and US GAAP. However, differences might exist between IFRSs and US GAAP in the profit margin reported in those contracts because of differences in other standards relating to accounting for the costs of fulfilling a contract (for example, IAS 2 or ASC Topic 330).

IN25 For some contracts (for example, many retail transactions), the proposed requirements would have little, if any, effect on current practice. However, the proposed requirements would differ from current practice in the following ways:

(a) *recognition of revenue only from the transfer of goods or services*—contracts for the development of an asset (for example, construction, manufacturing and customised software) would result in continuous revenue recognition only if the customer controls the asset as it is developed.

(b) *identification of separate performance obligations*—an entity would be required to divide a contract into separate performance obligations for goods or services that are distinct. As a result of those requirements, an entity might separate a contract into units of accounting that differ from those identified in current practice.

(c) *licensing and rights to use*—an entity would be required to evaluate whether a licence to use the entity's intellectual property (for less than the property's economic life) is granted on an exclusive or non-exclusive basis. If a licence is granted on an exclusive basis, an entity would be required to recognise revenue over the term of the licence. That pattern of revenue recognition might differ from current practice.

(d) *effect of credit risk*—in contrast to some existing standards and practices, the effect of a customer's credit risk (ie collectibility) would affect *how much* revenue an entity recognises rather than *whether* an entity recognises revenue.

(e) *use of estimates*—in determining the transaction price (for example, estimating variable consideration) and allocating the transaction price on the basis of stand-alone selling prices, an entity would be required to use estimates more extensively than in applying existing standards.

(f) *accounting for costs*—the proposed requirements specify which contract costs an entity would recognise as expenses when incurred and which costs would be capitalised because they give rise to an asset. Applying that cost guidance might change how an entity would account for some costs.

(g) *disclosure*—the proposed requirements specify disclosures to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. An entity would be required to disclose more information about its contracts with customers than is currently required, including more disaggregated information about recognised revenue and more information about its performance obligations remaining at the end of the reporting period.

When would the proposals be effective?

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

Questions for respondents

IN27 The boards invite individuals and organisations to comment on all matters in this exposure draft, particularly on the issues and questions below. Comments are requested from those who agree with the proposals as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposals are asked to describe their suggested alternatives, supported by specific reasoning.

IN28 Respondents should submit one comment letter to either the FASB or the IASB. The boards will share and jointly consider all comment letters received.

Recognition of revenue (paragraphs 8–33)

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

(a) to combine two or more contracts and account for them as a single contract;

(b) to segment a single contract and account for it as two or more contracts; and

(c) to account for a contract modification as a separate contract or as part of the original contract.

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

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

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

Measurement of revenue (paragraphs 34–53)

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

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

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

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

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

Contract costs (paragraphs 57–63)

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

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

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

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

Disclosure (paragraphs 69–83)

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

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

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

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

Effective date and transition (paragraphs 84 and 85)

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

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

Application guidance (paragraphs B1–B96)

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

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

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

(b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

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

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

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

(b) if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer the licence and it satisfies that obligation when the customer is able to use and benefit from the licence.

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

Consequential amendments

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

Non-public entities

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

Public round-table meetings

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

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

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

Introduction

1 This [draft] IFRS specifies the accounting for revenue (and some costs) arising from contracts with customers. It does not address revenue arising from other transactions or activities (for example, revenues arising from changes in the value of some mineral, biological or agricultural assets).

2 The core principle in this [draft] IFRS is that an entity shall recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration the entity receives, or expects to receive, in exchange for those goods or services. To apply this [draft] IFRS, an entity shall:

(a) identify the contract(s) with a customer;

(b) identify the separate performance obligations in the contract;

(c) determine the transaction price;

(d) allocate the transaction price to the separate performance obligations; and

(e) recognise revenue when the entity satisfies each performance obligation.

3 An entity shall consider the terms of the contract and all related facts and circumstances when using judgement in the application of this [draft] IFRS. An entity shall apply this [draft] IFRS consistently to contracts with similar characteristics and in similar circumstances.

4 [This paragraph in the FASB exposure draft is not used in the IASB exposure draft]

Objective

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

Scope

6 This [draft] IFRS applies to all contracts with customers except:

(a) lease contracts within the scope of IAS 17 *Leases*;

(b) insurance contracts within the scope of IFRS 4 *Insurance Contracts*;

(c) contractual rights or obligations within the scope of IFRS 9 *Financial Instruments* or IAS 39 *Financial Instruments: Recognition and Measurement*; and

(d) [this paragraph in the FASB exposure draft is not used in the IASB exposure draft]

(e) non-monetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange (for example, an exchange of oil to fulfil demand on a timely basis in a specified location).

7 A contract with a customer may be partially within the scope of this [draft] IFRS and partially within the scope of other IFRSs. If the other IFRSs specify how to separate and/or initially measure any parts of the contract, an entity shall first apply those separation and/or measurement requirements. If the other IFRSs do not specify how to separate and/or initially measure any parts of the contract, the entity shall apply this [draft] IFRS to separate and/or initially measure those parts of the contract.

Recognition of revenue

Identifying the contract

8 An entity shall apply this [draft] IFRS to each contract identified in accordance with paragraphs 9–19.

9 Contracts can be written, oral or implied by the entity's customary business practice. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities, and they may also vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining whether a contract exists.

10 A contract exists for the purpose of applying the revenue requirements of this [draft] IFRS only if:

(a) the contract has commercial substance (ie the entity's future cash flows are expected to change as a result of the contract);

(b) the parties to the contract have approved the contract and are committed to satisfying their respective obligations;

(c) the entity can identify each party's enforceable rights regarding the goods or services to be transferred; and

(d) the entity can identify the terms and manner of payment for those goods or services.

11 A contract does not exist for the purpose of applying this [draft] IFRS if either party can terminate a wholly unperformed contract without penalty. A wholly unperformed contract is a contract under which the entity has not transferred any goods or services and the customer has not paid any consideration.

Combination and segmentation of contracts (see paragraph B2)

12 In most cases, an entity applies this [draft] IFRS to a single contract with a customer. However, in some cases, the amount and timing of revenue might depend on whether an entity combines contracts or segments a contract.

13 An entity shall combine two or more contracts and account for them as a single contract if the amount of consideration for goods or services in one contract is dependent on the amount of consideration for goods or services in another contract—in other words, the prices of the contracts are interdependent. Indicators that two or more contracts have interdependent prices include the following:

(a) the contracts are entered into at or near the same time;

(b) the contracts are negotiated as a package with a single commercial objective; and

(c) the contracts are performed either concurrently or consecutively.

14 The price of a contract is not interdependent with the price of another contract solely because the customer receives a discount on goods or services in the contract as a result of an existing customer relationship arising from previous contracts.

15 Conversely, an entity shall segment a single contract and account for it as two or more contracts if the price of some goods or services in the contract is independent of the price of other goods or services in the contract. Goods or services are priced independently of other goods or services in the same contract only if both of the following conditions are met:

(a) the entity, or another entity, regularly sells identical or similar goods or services separately; and

(b) the customer does not receive a significant discount for buying some goods or services together with other goods or services in the contract.

16 If an entity segments a contract in accordance with paragraph 15, the entity shall allocate the total amount of consideration to each identified contract in proportion to the *stand-alone selling prices* of the goods or services in each identified contract (ie on a relative stand-alone selling price basis). An entity shall allocate subsequent changes in the amount of consideration only to the identified contract to which those changes relate (for example, changes arising because the amount of consideration is variable as described in paragraphs 35 and 36).

Contract modifications (see paragraph B3)

17 A contract modification is any change in the scope or price of a contract. Examples include changes in the nature or amount of the goods or services to be transferred, changes in the method or timing of performance, and changes in the previously agreed pricing in the contract. A contract modification may be initiated by either the customer or the entity.

18 An entity shall apply the revenue requirements of this [draft] IFRS to a contract modification only if the conditions in paragraph 10 are met.

19 An entity shall account for a contract modification together with the existing contract if the prices of the modification and the existing contract are interdependent (as described in paragraph 13). In that case, the entity shall recognise the cumulative effect of the contract modification in the period in which the modification occurs. Hence, the cumulative accounting after the contract modification shall be the same as it would have been if the modification had been included in the existing contract. If the prices of the contract modification and the existing contract are not interdependent, the entity shall account for the contract modification as a separate contract.

Identifying separate performance obligations (see paragraphs B4–B43)

20 **An entity shall evaluate the terms of the contract and its customary business practice to identify all promised goods or services and determine whether to account for each promised good or service as a separate *performance obligation*.**

21 Contracts with customers oblige an entity to provide goods or services in exchange for consideration. Goods or services include the following:

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

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

(c) arranging for another party to transfer goods or services (for example, acting as an agent of another party);

(d) standing ready to provide goods or services (for example, when-and-if available software products);

(e) constructing or developing an asset on behalf of a customer;

(f) granting licences, rights to use and options; and

(g) performing a contractually agreed task (or tasks).

22 If an entity promises to transfer more than one good or service, the entity shall account for each promised good or service as a separate performance obligation only if it is distinct. If a good or service is not distinct, an entity shall combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that is distinct. In some cases, that would result in an entity accounting for all the goods or services promised in the contract as a single performance obligation.

23 A good or service, or a bundle of goods or services, is distinct if either:

(a) the entity, or another entity, sells an identical or similar good or service separately; or

(b) the entity could sell the good or service separately because the good or service meets both of the following conditions:

(i) it has a distinct function—a good or service has a distinct function if it has utility either on its own or together with other goods or services that the customer has acquired from the entity or are sold separately by the entity or by another entity; and

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

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

Satisfaction of performance obligations (see paragraphs B44–B73)

25 An entity shall recognise revenue when it satisfies a performance obligation identified in accordance with paragraphs 20–24 by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains *control* of that good or service.

26 A customer obtains control of a good or service when the customer has the ability to direct the use of, and receive the benefit from, the good or service. Control includes the ability to prevent other entities from directing the use of, and receiving the benefit from, a good or service.

27 The customer's ability to direct the use of a good or service (ie an asset) refers to the present right to use the asset for its remaining economic life or to consume the asset in the customer's activities. The customer's ability to receive the benefit from an asset refers to its present right to obtain substantially all of the potential cash flows from that asset (either an increase in cash inflows or a decrease in cash outflows). The customer can obtain cash flows from an asset directly or indirectly in many ways such as by using, consuming, selling, exchanging, pledging or holding the asset.

28 If an entity retains some rights to an asset solely as protection against the customer's failure to comply with the terms of the contract (for example, when an entity retains legal title as protection against the customer's failure to pay), those rights are protective rights and do not preclude a customer from obtaining control of an asset.

29 When assessing whether a customer obtains control of an asset, an entity shall consider any related arrangements entered into at or near the same time as, or in contemplation of, the contract (for example, repurchase agreements).

30 An entity shall assess the transfer of control of goods or services for each separate performance obligation. Indicators that the customer has obtained control of a good or service include the following:

(a) The customer has an unconditional obligation to pay—if a customer is unconditionally obliged to pay for a good or service, typically that is because the customer has obtained control of the good or service in exchange. An obligation to pay is unconditional when nothing other than the passage of time is required before the payment is due.

(b) The customer has legal title—legal title often indicates which party has the ability to direct the use of, and receive the benefit from, a good. Benefits of legal title include the ability to sell a good, exchange it for another asset, or use it to secure or settle debt. Hence, the transfer of legal title often coincides with the transfer of control. However, in some cases, possession of legal title is a protective right and may not coincide with the transfer of control to a customer.

(c) The customer has physical possession—in many cases, the customer's physical possession of a good gives the customer the ability to direct the use of that good. In some cases, however, physical possession does not coincide with control of a good. For example, in some consignment and in some sale and repurchase arrangements, an entity may have transferred physical possession but retained control of a good. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of a good that the customer controls.

(d) The design or function of the good or service is customer-specific—a good or service with a customer-specific design or function might be of little value to an entity because the good or service lacks an alternative use. For instance, if an entity cannot sell a customer-specific asset to another customer, it is likely that the entity would require the customer to obtain control of the asset (and pay for any work completed to date) as it is created. A customer's ability to specify only minor changes to the design or function of a good or service or to choose from a range of standardised options specified by the entity typically would not indicate a customer-specific good or service. However, a customer's ability to specify major changes to the design or function of the good or service would indicate that a customer obtains control of the asset as it is created.

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

Continuous transfer of goods or services

32 When the promised goods or services underlying a separate performance obligation are transferred to a customer continuously, an entity shall apply to that performance obligation one revenue recognition method that best depicts the transfer of goods or services to the customer. The entity shall apply that method consistently to similar performance obligations and in similar circumstances.

33 Suitable methods of recognising revenue to depict the continuous transfer of goods or services to the customer include the following:

(a) output methods that recognise revenue on the basis of units produced or delivered, contract milestones, or surveys of goods or services transferred to date relative to the total goods or services to be transferred. Output methods often result in the most faithful depiction of the transfer of goods or services. However, other methods may also provide a faithful depiction but at a lower cost.

(b) input methods that recognise revenue on the basis of efforts expended to date (for example, costs of resources consumed, labour hours expended and machine hours used) relative to total efforts expected to be expended. Inputs often are more directly observable than outputs. However, a significant drawback of input methods is that there may not be a direct relationship between the efforts expended and the transfer of goods or services because of deficiencies in the entity's performance or other factors. When using an input method, an entity shall exclude the effects of any inputs that do not depict the transfer of goods or services to the customer (for example, the costs of abnormal amounts of wasted materials, labour or other resources to fulfil the contract).

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

Measurement of revenue

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

Determining the transaction price (see paragraphs B74–B85)

35 An entity shall consider the terms of the contract and its customary business practice to determine the transaction price for the contract with the customer. The transaction price reflects the probability-weighted amount of consideration that an entity expects to receive from the customer in exchange for transferring goods or services.

36 In many contracts, the transaction price is readily determinable because the customer promises to pay a fixed amount of consideration and that payment is made at or near the time of the transfer of the promised goods or services. In other contracts, the amount of consideration is variable, and the transaction price must be estimated at each reporting period to represent faithfully the circumstances present at the reporting date and the changes in circumstances during the reporting period. The amount of consideration could vary because of discounts, rebates, refunds, credits, incentives, performance bonuses/penalties, contingencies, price concessions, the customer's credit risk or other similar items.

37 If an entity receives consideration from a customer and expects to refund some or all of that consideration to the customer, the entity shall recognise a refund liability. The entity shall measure that liability at the probability-weighted amount of consideration that the entity expects to refund to the customer (ie the difference between the amount of consideration received and the transaction price). The refund liability shall be updated at each reporting period for changes in circumstances.

38 An entity shall recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. The transaction price can be reasonably estimated only if both of the following conditions are met:

(a) the entity has experience with similar types of contracts (or access to the experience of other entities if it has no experience of its own); and

(b) the entity's experience is relevant to the contract because the entity does not expect significant changes in circumstances.

39 Factors that reduce the relevance of an entity's experience include the following:

(a) the consideration amount is highly susceptible to external factors (for example, volatility in the market, judgement of third parties and risk of obsolescence of the promised good or service);

(b) the uncertainty about the amount of consideration is not expected to be resolved for a long time;

(c) the entity's experience with similar types of contracts is limited; and

(d) the contract has a large number of possible consideration amounts.

40 The existence of one or more of the above factors, in the light of the significance of other factors, may not be sufficient to prevent an entity's making a reasonable estimate of the transaction price; likewise, other factors may preclude a reasonable estimate.

41 If the transaction price cannot be reasonably estimated, an entity shall not recognise revenue from satisfying a performance obligation. If circumstances change, the entity shall recognise revenue from satisfied performance obligations when the transaction price can be reasonably estimated. If an entity can reasonably estimate some, but not all, of the consideration amount (for example, if part of the total consideration is a fixed amount), the transaction price includes only the amount that the entity can reasonably estimate.

42 When determining the transaction price, an entity shall consider the effects of:

(a) collectibility;

(b) the time value of money;

(c) non-cash consideration; and

(d) consideration payable to the customer.

Collectibility

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

The time value of money

44 In determining the transaction price, an entity shall adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicitly or implicitly).

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

Non-cash consideration

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

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

Consideration payable to the customer

48 If an entity pays, or expects to pay, consideration to the customer (or to other parties that purchase the entity's goods or services from the customer) in the form of cash or credit, or other items that the customer can apply against amounts owed to the entity, the entity shall determine whether that amount is:

(a) a reduction of the transaction price and, hence, of revenue (ie the customer receives a discount on the entity's goods or services);

(b) a payment for a distinct good or service (as described in paragraph 23) that the customer supplies to the entity, in which case the entity shall account for the purchase of the good or service in the same way it accounts for other purchases from suppliers; or

(c) a combination of items (a) and (b), in which case the entity shall reduce the transaction price by the excess, if any, of consideration payable to the customer over the fair value of the good or service the entity receives from the customer. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, the entity shall account for the entirety of the consideration payable to the customer as a reduction of the transaction price.

49 If consideration paid (or expected to be paid) to a customer is a reduction of the transaction price, an entity shall recognise the reduction of revenue when the later of the following occurs:

(a) the entity transfers the promised goods or services to the customer; and

(b) the entity promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practice.

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

50 An entity shall allocate the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the good or service underlying each of those performance obligations at contract inception (ie on a relative stand-alone selling price basis).

51 The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately. A contractually stated price or a list price for a good or service shall not be presumed to represent the stand-alone selling price of that good or service. If a stand-alone selling price is not directly observable, an entity shall estimate it.

52 When estimating stand-alone selling prices, an entity shall maximise the use of observable inputs and shall apply estimation methods consistently for goods or services and customers with similar characteristics. Suitable estimation methods include the following:

(a) expected cost plus a margin approach—an entity could forecast its expected costs of satisfying a performance obligation and then add the margin that the entity would require for that good or service; and

(b) adjusted market assessment approach—an entity could evaluate the market in which it sells goods or services and estimate the price that customers in that market would be willing to pay for those goods or services. That approach might also include referring to prices from the entity's competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins.

Allocating subsequent changes in the transaction price

53 After contract inception, an entity shall allocate any changes in the transaction price to all performance obligations on the same basis as at contract inception. Amounts allocated to satisfied performance obligations shall be recognised as revenue, or a reduction of revenue, in the period in which the transaction price changes. An entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception.

Onerous performance obligations

54 An entity shall recognise a liability and a corresponding expense if a performance obligation is onerous.

55 A performance obligation is onerous if the present value of the probability-weighted costs that relate directly to satisfying that performance obligation (as described in paragraph 58) exceeds the amount of the transaction price allocated to that performance obligation. Before an entity recognises a liability for an onerous performance obligation, it shall recognise any impairment loss that has occurred on assets related to the contract (for example, inventory or an asset recognised in accordance with paragraph 57).

56 At each subsequent reporting date, an entity shall update the measurement of the liability for an onerous performance obligation using current estimates. An entity shall recognise changes in the measurement of that liability as an expense or as a reduction of an expense. When an entity satisfies the liability for an onerous performance obligation, it shall recognise the corresponding income as a reduction of an expense.

Contract costs (see paragraphs B89 and B90)

57 If the costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with another IFRS (for example, IAS 2 ***Inventories*****, IAS 16** ***Property, Plant and Equipment*** **or IAS 38** ***Intangible Assets*****), an entity shall recognise an asset only if those costs:**

(a) relate directly to a contract (or a specific contract under negotiation) as described in paragraph 58;

(b) generate or enhance resources of the entity that will be used in satisfying performance obligations in the future (ie the costs relate to future performance); and

(c) are expected to be recovered.

58 Costs that relate directly to a contract are:

(a) direct labour (for example, salaries and wages of employees who provide services direct to the customer);

(b) direct materials (for example, supplies used in providing services to the customer);

(c) allocations of costs that relate directly to the contract or contract activities (for example, costs of contract management and depreciation of tools and equipment used in fulfilling the contract);

(d) costs that are explicitly chargeable to the customer under the contract; and

(e) other costs that were incurred only because the entity entered into the contract (for example, subcontractor costs).

59 An entity shall recognise the following costs as expenses when incurred:

(a) costs of obtaining a contract (for example, the costs of selling, marketing, advertising, bid and proposal, and negotiations);

(b) costs that relate to satisfied performance obligations in the contract (ie the costs that relate to past performance); and

(c) costs of abnormal amounts of wasted materials, labour or other resources used to fulfil the contract.

60 If an entity cannot distinguish the costs that relate to future performance from the costs that relate to past performance, the entity shall recognise those costs as expenses when incurred.

61 An asset recognised in accordance with paragraph 57 shall be amortised on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates.

62 An entity shall classify an asset recognised in accordance with paragraph 57 on the basis of the nature or function of the costs that gave rise to the asset (for example, intangible or work in progress).

63 An entity shall recognise an impairment loss to the extent that the carrying amount of an asset recognised in accordance with paragraph 57 exceeds the amount of the transaction price allocated to the remaining performance obligations less the costs that relate directly to satisfying those performance obligations (as described in paragraph 58).

Presentation (see paragraph B91)

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

65 If an entity performs by transferring goods or services to a customer before the customer performs by paying consideration, the entity shall present the contract as a contract asset. Conversely, if a customer performs before an entity performs, the entity shall present the contract as a contract liability.

66 An entity shall present an unconditional right to consideration as a receivable (not as a contract asset) and shall account for that receivable in accordance with IFRS 9. A right to consideration is unconditional when nothing other than the passage of time is required before payment of that consideration is due.

67 An entity shall present any asset recognised in accordance with paragraph 57 separately from the contract asset or contract liability.

68 An entity shall present any liability recognised for an onerous performance obligation separately from any contract asset or contract liability.

Disclosure (see paragraphs B92–B96)

69 To help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, an entity shall disclose qualitative and quantitative information about:

(a) its contracts with customers (paragraphs 73–80); and

(b) the significant judgements, and changes in judgements, made in applying the [draft] IFRS to those contracts (paragraphs 81–83).

70 An entity shall consider the level of detail necessary to satisfy the disclosure requirements and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.

71 If the disclosures provided in accordance with this [draft] IFRS and other IFRSs do not meet the objective in paragraph 69, an entity shall disclose whatever additional information is necessary to meet that objective.

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

Contracts with customers

73 An entity shall disclose information about its contracts with customers to help users understand the amount, timing and uncertainty of revenue and cash flows from those contracts, including:

(a) a disaggregation of revenue for the period (paragraph 74);

(b) a reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities (paragraphs 75 and 76); and

(c) information about the entity's performance obligations (paragraphs 77 and 78), including additional information about its onerous performance obligations (paragraphs 79 and 80).

Disaggregation of revenue

74 An entity shall disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Examples of categories that might be appropriate include:

(a) type of good or service (for example, major product lines);

(b) geography (for example, country or region);

(c) market or type of customer (for example, government versus non-government customers); or

(d) type of contract (for example, a fixed-price versus a time-and-materials contract).

Reconciliation of contract balances

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

(a) the amount(s) recognised in the statement of comprehensive income arising from:

(i) revenue from performance obligations satisfied during the reporting period;

(ii) revenue from allocating changes in the transaction price to performance obligations satisfied in previous reporting periods;

(iii) interest income and expense; and

(iv) the effect of changes in foreign exchange rates;

(b) cash received;

(c) amounts transferred to receivables;

(d) non-cash consideration received; and

(e) contracts acquired in business combinations and contracts disposed.

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

Performance obligations

77 An entity shall disclose information about its performance obligations in contracts with customers, including a description of:

(a) the goods or services the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (ie if the entity is acting as an agent);

(b) when the entity typically satisfies its performance obligations (for example, upon shipment, upon delivery, as services are rendered or upon completion of service);

(c) the significant payment terms (for example, whether the consideration amount is variable and whether the contract has a material financing component);

(d) obligations for returns, refunds and other similar obligations; and

(e) types of warranties and related obligations.

78 For contracts with an original expected duration of more than one year, an entity shall disclose the amount of the transaction price allocated to the performance obligations remaining at the end of the reporting period that are expected to be satisfied in each of the following periods:

(a) not later than one year;

(b) later than one year but not later than two years;

(c) later than two years but not later than three years; and

(d) later than three years.

Onerous performance obligations

79 An entity shall disclose the amount of any liability recognised for onerous performance obligations together with a discussion of:

(a) the nature and amount of the performance obligations for which the liability has been recognised;

(b) why those performance obligations have become onerous; and

(c) when the entity expects to satisfy the liability.

80 An entity shall provide a reconciliation from the opening to the closing balance of the liability recognised for onerous performance obligations. The reconciliation shall show the amounts recognised in the statement of comprehensive income attributable to each of the following, if applicable:

(a) performance obligations that became onerous during the period;

(b) performance obligations that ceased to be onerous during the period;

(c) amount of the liability that was satisfied during the period;

(d) the time value of money; and

(e) changes in the measurement of the liability that occurred during the reporting period.

Significant judgements in the application of the [draft] IFRS

81 An entity shall disclose the judgements, and changes in judgements, made in applying this [draft] IFRS that significantly affect the determination of the amount and timing of revenue from contracts with customers. That disclosure shall explain the judgements used in:

(a) determining the timing of satisfaction of performance obligations (paragraph 82); and

(b) determining the transaction price and allocating it to performance obligations (paragraph 83).

Determining the timing of satisfaction of performance obligations

82 For performance obligations satisfied continuously, an entity shall disclose:

(a) the methods (for example, output methods, input methods and methods based on the passage of time) used to recognise revenue; and

(b) an explanation of why such methods are a faithful depiction of the transfer of goods or services.

Determining the transaction price and allocating it to performance obligations

83 An entity shall disclose information about the methods, inputs and assumptions used:

(a) to determine the transaction price in accordance with paragraphs 35–49;

(b) to estimate stand-alone selling prices of promised goods or services;

(c) to measure obligations for returns, refunds and other similar obligations;

(d) to measure the amount of any liability recognised for onerous performance obligations (including information about the discount rate).

Effective date and transition

84 An entity shall apply this [draft] IFRS for annual periods beginning on or after [date to be inserted after exposure].

85 An entity shall apply this [draft] IFRS retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Withdrawal of other IFRSs

86 This [draft] IFRS supersedes the following IFRSs:

(a) IAS 11 *Construction Contracts*;

(b) IAS 18 *Revenue*;

(c) IFRIC 13 *Customer Loyalty Programmes*;

(d) IFRIC 15 *Agreements for the Construction of Real Estate*;

(e) IFRIC 18 *Transfers of Assets from Customers;* and

(f) SIC-31 *Revenue—Barter Transactions Involving Advertising Services*.

Appendix A
Defined terms

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

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

Appendix B
Application guidance

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

B1 The application guidance gives guidance on the following issues*:

(a) segmentation of a contract (paragraph B2);

(b) contract modifications (paragraph B3);

(c) identifying performance obligations (paragraphs B4–B39);

(d) determining whether a good or service is distinct (paragraphs B40–B43);

(e) satisfaction of performance obligations (paragraphs B44–B73);

(f) determining the transaction price (paragraphs B74–B85);

(g) allocating the transaction price to separate performance obligations (paragraphs B86–B88);

(h) contract costs (paragraphs B89 and B90);

(i) presentation (paragraph B91); and

(j) disclosure (paragraphs B92–B96).

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

Segmentation of a contract (paragraphs 15 and 16)

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

Example 1—Contract segmentation
An entity enters into a contract with a customer to sell Products A, B and C for CU36.* The entity regularly sells Products A, B and C separately for CU9, CU11 and CU20, respectively. It also regularly sells Products A and B together for CU16.
The entity segments the contract into two contracts: a contract to provide Products A and B, and a contract to provide Product C. The stand-alone selling price of Products A and B together (CU16) is independent of the stand-alone selling price of Product C. That is because the entity regularly sells Products A and B together at CU16 and Product C at CU20, and the customer does not receive a discount for buying Products A and B together with Product C (the total price for all of the products in the contract [CU36] equals the sum of the stand-alone selling prices for Products A and B together [CU16] and Product C [CU20]).
The effect of segmenting the contract into two contracts is that the CU4 discount for purchasing Products A and B together is allocated only to Products A and B.

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

Contract modifications (paragraphs 17–19)

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

Example 2—Contract modifications
Scenario 1—services that do not have interdependent prices
An entity enters into a three-year services contract. The payment terms are CU100,000 payable annually in advance. The stand-alone selling price of the services at contract inception is CU100,000 per year. At the beginning of the third year (after the customer had paid the CU100,000 for that year), the entity agrees to reduce the price for the third year of services to CU80,000. In addition, the customer agrees to pay an additional CU220,000 for an extension of the contract for three years. The stand-alone selling price of the services at the beginning of the third year is CU80,000 per year.
To account for the contract modification, the entity must evaluate whether the price of the services provided before the contract modification and the price of the services provided after the contract modification are interdependent. The services provided during the first two years are priced at the stand-alone selling price of CU100,000 per year. Moreover, the services provided during the subsequent four years are priced at the stand-alone selling price of CU80,000 per year. Hence, the entity concludes that the price of the contract modification and the price of the original contract are not interdependent. Although the services are provided continuously, the price of the services in the first two years and the price of the subsequent services are negotiated at different times and in different market conditions (as evidenced by the significant change in the stand-alone selling price of the service).
Consequently, the entity accounts for the contract modification separately from the original contract. CU20,000 of the CU100,000 payment received at the beginning of the third year (before the modification) is a prepayment of services to be provided in the future years. Therefore, the entity recognises revenue of CU100,000 per year for the two years of services provided under the original contract and CU80,000 per year for services provided during the subsequent four years of services under the new contract.
continued...

...continued

Example 2—Contract modifications

Scenario 2—services that have interdependent prices

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

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

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

Identifying performance obligations (paragraphs 20–24)

B4 Paragraph 20 requires an entity to evaluate the terms of the contract and its customary business practice to identify all promised goods or services and determine whether to account for each promised good or service as a separate performance obligation. An entity shall consider the following guidance when applying that requirement:

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

(b) product warranties and product liabilities (paragraphs B13–B19);

(c) principal versus agent considerations (paragraphs B20–B23);

(d) customer options for additional goods or services (paragraphs B24–B26);

(e) non-refundable upfront fees (paragraphs B27–B30); and

(f) licensing and rights to use (paragraphs B31–B39).

Sale of a product with a right of return

B5 In some contracts, an entity transfers a product to a customer and also grants the customer (either contractually or by customary business practice) the right to return the product to the entity. The likelihood of a return and the duration of the return period vary significantly across industries. For example, the perishable food industry typically has a lower rate of return and a shorter return period than the publishing industry.

B6 Reasons for a product's return include customer dissatisfaction with the product or the customer's failure to sell the product (if the customer is in the business of reselling products purchased from the entity). Contracts in which a customer may return a defective product shall be evaluated in accordance with the guidance on warranties in paragraphs B13–B19.

B7 A customer returning a product may receive any combination of the following:

(a) a full or partial refund of any consideration paid;

(b) a credit that can be applied to amounts owed or to be owed for other goods or services; or

(c) another product in exchange.

B8 Exchanges by customers of one product for another of the same type, quality, condition and price (for example, one colour or size for another) are not considered returns for the purposes of applying this [draft] IFRS.

B9 An entity's promise to stand ready to accept a returned product during the return period shall not be accounted for as a separate performance obligation in addition to the obligation to provide a refund. Instead, an entity shall recognise both of the following:

(a) revenue for the transferred goods that are not expected to be returned; and

(b) a refund liability (in accordance with paragraph 37).

B10 If an entity cannot reasonably estimate the probability of a refund to the customer in accordance with paragraphs 38–40, the entity shall not recognise revenue when it transfers the product but shall recognise any consideration received as a refund liability. In such cases, the entity shall recognise revenue when it can reasonably estimate the probability of a refund (which may be only when the return period expires).

B11 In accordance with paragraph 37, an entity shall update the measurement of the refund liability at the end of each reporting period for changes in expectations about the amount of refunds and make a corresponding adjustment to the amount allocated to the satisfied performance obligations.

B12 An entity shall recognise an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability. The asset shall initially be measured by reference to the former carrying amount of the inventory less any expected costs to recover those products. Subsequently, an entity shall update the measurement of the asset to correspond with changes in the measurement of the refund liability.

Example 3—Right of return

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

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

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

(a) revenue of CU9,700 (CU100 × 97 products expected not to be returned);

(b) a refund liability for CU300 (CU100 × 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. Hence, the amount recognised in cost of sales for 97 products is CU5,820 (CU60 × 97).

Product warranties and product liabilities

B13 It is common for an entity to provide (whether explicitly in the contract or implicitly by customary business practice) a product warranty with the sale of a product. In some contracts, the product warranty may be included in the selling price of the product. In other contracts, the warranty may be priced separately as an optional extra or may be provided by a party other than the seller of the product.

B14 An entity shall assess the objective of the product warranty. If its objective is to provide a customer with coverage for latent defects in the product (ie defects that exist when the product is transferred to the customer but are not yet apparent), that warranty does not give rise to a performance obligation in addition to the performance obligation to transfer the product. Instead, the warranty requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract. Therefore, at the reporting date the entity shall determine the likelihood and extent of defective products that it has sold to customers and, hence, the amount of unsatisfied performance obligations to transfer those products.

B15 Consequently, if the entity would be required to replace defective products, it does not recognise any revenue for those defective products when it transfers them to customers. If the entity would be required to repair defective products, it does not recognise revenue for the portion of the transaction price attributed to the products' components expected to be replaced in the repair process.

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

Example 4—Product warranty that is not a performance obligation

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

At 31 December, the entity would estimate that it has provided 10 (1,000 × 1%) defective products that need to be replaced. Hence, for those products it recognises remaining performance obligations of CU10,000 (10 products × CU1,000). It recognises revenue for those products only when the customers obtain control of products without defects.

Because the entity has not satisfied all of its performance obligations at 31 December with respect to the products, the entity also would recognise an asset measured at CU6,000 (10 products × CU600 per product). That asset represents the inventory that the entity has not yet transferred to the customer and is measured in accordance with IAS 2 *Inventories*.

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

At 31 January, no products have been replaced, but conditions change so that the entity estimates that 12 products will need to be replaced. Hence, the entity recognises remaining performance obligations of CU12,000 (12 products × CU1,000). The CU2,000 (CU12,000 − CU10,000) increase is recognised as a reduction of revenue. The entity also would increase the measurement of the asset to CU7,200 (12 products × CU600 per product) and recognise a corresponding adjustment to cost of sales.

B17 If the objective of a warranty is to provide a customer with coverage for faults that arise after the product is transferred to the customer, that warranty gives rise to a performance obligation for warranty services in addition to the performance obligation to transfer the promised product. Therefore, an entity shall allocate the transaction price (on a relative stand-alone selling price basis) between the promised product and the promised warranty service.

B18 In assessing whether the objective of the product warranty is to provide a customer with coverage for latent defects in the product or to provide a customer with coverage for faults that arise after the product is transferred to the customer, an entity considers factors such as:

(a) whether the warranty is required by law—if the entity is required by law to provide a warranty, that indicates that the warranty is not a performance obligation, because such requirements typically exist to protect customers from the risk of purchasing defective products.

(b) whether the product could have been sold without the warranty—if the product could not be sold without a warranty, that indicates the warranty is not a performance obligation. Conversely, if a warranty is sold as an optional extra, it is a separate performance obligation in accordance with paragraph 23(a).

(c) the length of the warranty coverage period—the longer the coverage period, the more likely that the warranty (or part of the warranty) is a performance obligation because it is more likely to provide coverage for faults arising after the product is transferred to the customer.

B19 A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. For example, a manufacturer might sell products in a jurisdiction in which the law holds the manufacturer liable for any damages (for example, to personal property) that might be caused by a consumer using a product for its intended purpose. Similarly, an entity's promise to indemnify the customer for liabilities and damages arising from claims of patent, copyright, trademark or other infringement by the entity's products does not give rise to a performance obligation. The entity shall account for such obligations in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Principal versus agent considerations

B20 In some contracts, an entity's customer might receive goods or services from a party other than the entity (for example, a service provider might procure and service equipment that is manufactured by another party). When other parties are involved in providing goods or services to an entity's customer, the entity must determine whether its performance obligation is to provide the goods or services itself (ie the entity is a principal), or to arrange for another party to provide those goods or services (ie the entity is an agent). That determination affects whether the entity recognises revenue in the amount of consideration received in exchange for those goods or services (if a principal) or in the amount of any fee or commission received in exchange for arranging for the other party to provide their goods or services (if an agent). An entity's fee or commission might be the net amount of consideration that the entity retains after paying other parties for providing their goods or services to the customer.

B21 If an entity obtains control of the goods or services of another party before it transfers those goods or services to the customer, the entity's performance obligation is to provide the goods or services itself. Hence, the entity is acting as a principal and shall recognise revenue in the gross amount receivable from the customer.

B22 Indicators that the entity's performance obligation is to arrange for the provision of goods or services by another party (ie that the entity is an agent and shall recognise revenue net) include the following:

(a) the other party is primarily responsible for fulfilment of the contract;

(b) the entity does not have inventory risk before or after the customer order, during shipping or on return;

(c) the entity does not have latitude in establishing prices for the other party's goods or services and, hence, the benefit that the entity can receive from those goods or services is constrained;

(d) the entity's consideration is in the form of a commission; and

(e) the entity does not have customer credit risk for the amount receivable in exchange for the other party's goods or services.

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

Customer options for additional goods or services

B24 In many contracts, an entity grants a customer the option to acquire additional goods or services free of charge or at a discount. Those options come in many forms, including sales incentives, customer award credits (or points), contract renewal options or other discounts on future goods or services.

B25 If an entity grants a customer the option to acquire additional goods or services, that promise gives rise to a separate performance obligation in the contract only if the option provides a material right to the customer that the customer would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires.

Example 5—Sale of a product and a future discount
An entity enters into a contract for the sale of Product A for CU100. As part of the contract, the entity gives the customer a 40 per cent discount voucher for any future purchases in the next 30 days up to CU100. The entity intends to offer a 10 per cent discount on all sales during the next 30 days as part of a seasonal promotion. Because the discount voucher provides a material right to the customer that the customer would not receive without entering into that contract, the entity concludes that the discount voucher is a separate performance obligation in the contract for the sale of Product A. (Example 25 illustrates how much of the transaction price of CU100 would be allocated to the discount voucher.)

B26 If a customer has the option to acquire an additional good or service at a price that is within the range of prices typically charged for those goods or services, that option does not provide the customer a material right even if the option can be exercised only because of entering into a previous contract. The entity has merely made a marketing offer.

Example 6—Telecommunication services
A telecommunications entity enters into a contract with a customer to provide up to 600 call minutes and 100 text messages each month for a fixed monthly fee. The contract specifies the price for any additional call minutes or texts that the customer may opt to purchase in any month. The entity determines that the customer's fixed monthly payments do not include a prepayment for future services because the prices of the additional call minutes and texts are within the range of prices typically charged for those services. Consequently, even though in this example the customer can exercise the option for any additional call minutes and text messages only because it entered into a contract, the option does not grant the customer a material right and, therefore, is not a performance obligation in the contract. Hence, the entity would recognise revenue for additional call minutes and texts only if and when the customer receives those additional services.

Non-refundable upfront fees

B27 In some contracts, an entity charges a customer a non-refundable upfront fee at or near contract inception. Examples include joining fees in health club membership contracts, activation fees in telecommunication contracts, set-up fees in outsourcing contracts and initial fees in supply contracts.

B28 To identify performance obligations in such contracts, an entity shall assess whether the fee relates to the transfer of a promised good or service. In many cases, even though a non-refundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfil the contract, that activity does not result in the transfer of a promised good or service to the customer. Rather, the upfront fee is an advance payment for future goods or services and, hence, would be recognised as revenue when those future goods or services are provided. That revenue recognition period would extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right as discussed in paragraphs B24–B26.

Example 7—Non-refundable upfront fees
Scenario 1—health club membership A health club entity enters into a contract with a customer for one year of access to any of its health clubs. The entity charges the customer a non-refundable joining fee in part as compensation for the initial activities of registering the customer. The customer can renew the contract each year without paying the joining fee. The entity's activity of registering the customer does not transfer any service to the customer and, hence, is not a performance obligation. The customer's right to access the entity's health clubs over a specified period is a right that the customer has as a result of entering into the contract. The promised service under the contract (access to a chain of health clubs) can be provided to the customer only over time. Therefore, the joining fee is included in the transaction price allocated to the performance obligation to provide access to the health clubs and to the option to renew. Consequently, the non-refundable joining fee is recognised as revenue during the period that the entity expects to provide services to the customer. *Scenario 2—payroll processing* A payroll processing entity charges a non-refundable set-up fee at contract inception in addition to the periodic fees for the ongoing payroll processing services. The set-up fee compensates the entity for its activities of establishing the necessary records in its systems in order to be able to provide the payroll processing services. The customer can renew the contract each year without paying the set-up fee. The entity's activities in establishing the records in its systems do not transfer any service to the customer and, hence, are not a performance obligation. The promised service under the contract is the payroll processing. Accordingly, the set-up fee is included in the transaction price allocated to the performance obligation to provide payroll processing and to the option to renew. Consequently, the non-refundable set-up fee is recognised as revenue during the period that the entity expects to provide services to the customer.

B29 If the non-refundable upfront fee relates to a performance obligation, the entity shall evaluate whether to account for that performance obligation separately in accordance with paragraphs 20–24.

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

Licensing and rights to use

B31 Licensing refers to an entity's granting a customer the right to use, but not own, intellectual property of the entity. Intellectual property includes all of the following:

(a) software and technology;

(b) motion pictures, music and other forms of media and entertainment;

(c) franchises;

(d) patents, trademarks and copyrights; and

(e) other intangible assets.

B32 IAS 17 *Leases* provides guidance on rights to use specified types of assets.

B33 If a customer obtains control of substantially all the rights associated with the entity's intellectual property, the contract shall be considered to be a sale rather than licensing of the intellectual property. That would be the case, for instance, if an entity grants a customer the exclusive right to use its intellectual property for substantially all of the property's economic life.

B34 If a customer does not obtain control of substantially all the rights associated with the entity's intellectual property and the entity has promised to grant exclusive rights to the customer, the entity has a performance obligation that it satisfies continuously during the period in which it permits the customer to use its intellectual property.

B35 If an entity grants rights that are not exclusive, the promised rights give rise to a single performance obligation. The entity satisfies that performance obligation when the customer is able to use and benefit from the rights, which is no sooner than the beginning of the licence period.

B36 Rights to use are not exclusive if an entity can grant similar rights to other customers under substantially the same terms. For example, with many software products, entities grant similar rights to many customers under substantially the same terms.

B37 An entity might grant rights to more than one customer to use the same intellectual property. However, the rights of one customer might substantially differ from the rights granted to another customer. Hence, those rights would be exclusive. An entity might grant exclusive rights on the basis of the following:

(a) time—for example, a motion picture studio granting one customer the exclusive right to air a television series during one time period and granting another customer the exclusive right to air the same series during another time period;

(b) geography—for example, a franchisor granting one customer the exclusive right to a franchise in a particular region and granting another customer the exclusive right to the franchise in a different region;

(c) distribution channel or medium—for example, a record label granting one customer the exclusive right to distribute a soundtrack on compact disc and granting another customer the exclusive right to distribute the soundtrack via the Internet.

B38 If an entity has a patent to intellectual property that it licenses to customers, the entity may represent and guarantee to its customers that it has a valid patent, and it will defend and maintain that patent. That promise to maintain and defend patent rights is not a performance obligation because it does not transfer a good or service to the customer. Defending a patent protects the intellectual property to which the entity has represented itself as having enforceable rights.

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

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

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

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

B41 The following example illustrates a good and a service that are distinct.

Example 9—Specialised equipment with installation
An entity enters into a contract to sell and install specialised equipment that it has manufactured. The installation could be performed by other entities in the industry. The equipment is distinct because, although the entity does not sell the equipment separately, the entity could sell it separately. The equipment has a distinct function because, although the equipment does not have utility on its own without the installation, it has utility together with installation services that are sold separately. Moreover, the profit margin on the equipment is distinct because it is subject to distinct risks and the entity can separately identify the resources required to provide the equipment. The installation services are distinct because similar services are sold by other entities separately. Therefore, the entity would identify separate performance obligations for the equipment and for the installation. However, in accordance with paragraph 24 the entity would not need to account for them separately if the customer obtains control of the equipment only after it has been installed.

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

Example 10—Technology licence with research and development services

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

(a) to grant to the customer exclusive rights to use the entity's Technology A for the life of its patent. The licence gives the customer the exclusive right to market, distribute and manufacture Drug B as developed using Technology A.

(b) to provide research and development services to the customer. The entity agrees to assign four full-time equivalent employees to the research and development services. The objective is to receive regulatory approval to market and distribute Drug B using Technology A.

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

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

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

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

Example 11—Construction contract
An entity enters into a contract to construct a facility for a customer. The construction project requires engineering (design), procurement and construction activities. The design of the facility is specific to the customer's requirements, and the customer is involved in specifying major structural and functional elements of the facility. The entity procures materials and equipment as they are needed during construction. The customer obtains control of those materials and equipment as they are installed. The construction of the facility is expected to take three years. The entity also guarantees that the facility will operate in accordance with agreed-upon specifications for two years from the date of completion of construction. Other entities could provide similar services. The design services are distinct because similar services are sold separately by the entity and by its competitors. In this example, procurement of the materials and equipment is not a performance obligation. Procurement is an activity that is necessary for the entity to obtain control of the promised materials and equipment and then to transfer them to the customer. Because the customer obtains control of the materials and equipment only as they are installed, they are transferred to the customer at the same time as the related installation services. Hence, the entity accounts for the materials and equipment together with the related installation service (in accordance with paragraph 24). *continued...*

...continued **Example 11—Construction contract**
During construction, the entity performs various tasks including site preparation, foundation development, structure erection, piping, wiring and site finishing (for example, paving a parking lot and landscaping). The customer could contract separately with other entities to perform each of those tasks. However, some of the tasks are highly interrelated, which requires the entity to provide a significant contract management service. That service includes managing and coordinating those tasks and covering the risk that those tasks do not combine to provide the integrated construction services for which the customer has contracted. The contract management service is not distinct. Similar services are not sold separately because the entity is integrating, and covering the risks of, a unique combination of tasks. The contract management service has a distinct function, but it does not have a distinct profit margin. The entity can separately identify the resources to provide the contract management service. However, the contract management service is not subject to distinct risks because the risks are inseparable from the risks of the related tasks. Because the contract management service is not distinct, the entity combines that service with the related tasks with inseparable risks. The entity identifies distinct risks for site preparation and site finishing. Hence, the entity accounts for those services as separate performance obligations. The remaining construction tasks are accounted for as a single performance obligation. The entity would account for the performance guarantee as a warranty as discussed in paragraphs B13–B19.

Satisfaction of performance obligations (paragraphs 25–33)

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

(a) software licence (paragraph B45);

(b) shipment of a product with risk of loss (paragraph B46);

(c) sale and repurchase of an asset (paragraphs B47–B53);

(d) consignment arrangements (paragraphs B54–B57);

(e) bill-and-hold arrangements (paragraphs B58–B62);

(f) determining whether goods or services are transferred continuously (paragraphs B63–B68); and

(g) customer acceptance (paragraphs B69–B73).

Software licence

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

Example 12—Software licence
An entity has previously licensed, on a non-exclusive basis, Product X to a customer on a compact disc that also included a copy of Products Y and Z. Each product requires an access code for the customer to use the software. Upon delivery of the compact disc, the entity provided the access code to Product X, but not for Products Y and Z. At the reporting date, the entity licenses Product Y to the customer but provides the access code to Product Y after the reporting date. In this example, the customer does not obtain control of the rights to Product Y at the reporting date because the customer cannot use Product Y until it obtains the access code. Therefore, the entity would recognise revenue for Product Y when the customer obtains the access code and, hence, the entity satisfies its performance obligation.

Shipment of a product with risk of loss

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

Example 13—Free on board shipping point and risk of loss
An entity enters into a contract to sell a product to a customer. The delivery terms are free on board shipping point (ie legal title to the product passes to the customer when the product is handed over to the carrier). The entity uses a third-party carrier to deliver the product. In accordance with the entity's past business practice, the entity will provide the customer with a replacement product, at no additional cost, if a product is damaged or lost while in transit. The entity has determined that its past business practice of replacing damaged products has implicitly created an enforceable obligation. Hence, the entity has performance obligations to provide the customer with a product and to cover the risk of loss during transit. The customer obtains control of the product at the point of shipment. Although it does not have physical possession of the product at that point, it has legal title and therefore can sell the product to (or exchange it with) another party. The entity is also precluded from selling the product to another customer. In this example, the additional performance obligation for risk coverage does not affect when the customer obtains control of the product. However, it does result in the customer's receiving a service from the entity while the product is in transit. Hence, the entity has not satisfied all of its performance obligations at the point of shipment and would not recognise all of the revenue at that point. Some revenue would be recognised as it covers the risk of loss during transit (subject to materiality).

Sale and repurchase of an asset

B47 Sometimes an entity sells an asset and also enters into a repurchase agreement (either in the same contract or in another contract). The repurchased asset may be the asset that was originally sold to the customer, an asset that is substantially the same as that asset, or another asset of which the asset that was originally sold is a component.

B48 Repurchase agreements come in three main forms:

(a) an entity's unconditional obligation to repurchase the asset (a forward);

(b) an entity's unconditional right to repurchase the asset (a call option); and

(c) a customer's unconditional right to require the entity to repurchase the asset (a put option).

B49 If an entity has an unconditional obligation or unconditional right to repurchase the asset (a forward or a call option), the customer is constrained in its ability to direct the use of, and receive the benefit from, the asset. Hence, the customer does not obtain control of the asset (even though the customer may have physical possession of the asset), and the entity shall account for the sale and repurchase agreement as:

(a) a right of use in accordance with IAS 17, if the entity repurchases the asset for an amount that is less than the original sales price of the asset; or

(b) a financing arrangement, if the entity repurchases the asset for an amount that is equal to or more than the original sales price of the asset.

B50 When comparing the repurchase price with the sales price, an entity shall adjust the prices to reflect the effects of the time value of money, if material.

B51 If the sale and repurchase agreement is a financing arrangement, the entity shall continue to recognise the asset and shall recognise a financial liability for any consideration received from the customer. The entity shall recognise the difference between the amount of consideration received from the customer and the amount of consideration paid to the customer as interest and, if applicable, holding costs (for example, insurance).

B52 If a customer has the unconditional right to require the entity to repurchase the asset (a put option), the customer obtains control of the asset and the entity shall account for the agreement similarly to the sale of a product with a right of return as discussed in paragraphs B5–B12. The following example illustrates how an entity would account for the sale of an asset with a put option.

Example 14—Sale and repurchase of an asset

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

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

(a) derecognise the asset:

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

(b) recognise revenue and a repurchase liability:

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

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

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

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

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

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

(b) recognise the repurchased asset:

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

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

Consignment arrangements

B54 Some entities deliver products to other parties (for example, dealers or distributors) on a consignment basis. Those arrangements help the entity to move its inventory closer to the point of sale to end customers and provide the other party with a wider range of inventory than might otherwise be practicable.

B55 When an entity delivers a product to another party such as a dealer or a distributor for sale to end customers, an entity shall evaluate whether the dealer or distributor has obtained control of the product at that point in accordance with paragraphs 26–31.

B56 Typically, inventory on consignment is owned by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer, or until a specified period expires. Until that point, the entity typically is able to require the return of the products or transfer them to another dealer. Moreover, the dealer typically does not have an unconditional obligation to pay for the products (although it might be required to pay a deposit). Accordingly, the entity would not recognise revenue upon delivery of the products to the dealer.

B57 If the dealer or distributor obtains control of the product before transferring the product to an end customer, it is a principal as discussed in paragraphs B20–B23 and shall recognise revenue when its customer obtains control of the product. If the dealer or distributor does not obtain control of the product, then it is an agent as discussed in paragraphs B20–B23 and shall recognise revenue when it has provided the service of arranging for the transfer of the product.

Bill-and-hold arrangements

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

B59 An entity determines when it has satisfied its performance obligation to transfer a product by evaluating when the customer obtains control of that product in accordance with paragraphs 26–31. In most contracts, that will be when the product is either delivered to the customer's delivery site or shipped to the customer, depending on the terms of the contract, including delivery or shipping terms. However, a customer may have obtained control of a product even though that product remains in the physical possession of the entity. In such cases, the customer has the ability to direct the use of, and receive the benefit from, the product even though it has decided to not exercise its right to use that product. Consequently, the entity does not have the ability to direct the use of, and receive the benefit from, the product. Instead the entity provides custodial services to the customer over the customer's asset.

B60 Accordingly, for a customer to have obtained control of a product in a bill-and-hold arrangement:

(a) the customer must have requested the contract to be on a bill-and-hold basis;

(b) the product must be identified separately as the customer's;

(c) the product currently must be ready for delivery at the location and time specified, or to be specified, by the customer; and

(d) the entity cannot use the product or sell it to another customer.

B61 In addition to evaluating whether the customer has obtained control of a product in a bill-and-hold arrangement in accordance with paragraphs 26–31, the entity also considers the conditions in paragraph 10 to assess whether a contract exists.

B62 If an entity recognises revenue from the sale of a product on a bill-and-hold basis, the entity shall consider whether the custodial services are a material separate performance obligation to which some of the transaction price shall be allocated.

Determining whether goods or services are transferred continuously

B63 In most contracts, it is straightforward to determine whether an entity has promised to transfer goods or services continuously or to transfer them at a point in time. In some contracts, however, it can be difficult to make that determination, particularly when an entity promises to produce, manufacture or construct an asset specifically for a customer (for example, construction-type, production-type and software development contracts). That determination affects whether an entity satisfies a performance obligation (and recognises revenue) continuously throughout the contract or only at the end of the contract when the customer obtains control of the completed asset.

B64 In such cases, an entity shall determine whether it has promised to transfer goods or services continuously by evaluating whether the customer controls the asset as it is produced, manufactured or constructed. Therefore, in accordance with paragraphs 26–31, the entity shall consider whether the customer has the ability to direct the use of, and receive the benefit from, the work in progress (rather than the completed asset). If the customer has that ability, the contract is to transfer goods or services continuously to the customer, and the entity would recognise revenue continuously to depict that transfer.

B65 If the customer does not control the asset as it is produced, manufactured or constructed, the contract is to transfer a completed asset. In that situation, an entity shall recognise revenue only when the customer obtains control of the completed asset.

B66 The following example illustrates situations in which the entity's contract is to provide services and those in which the entity's contract is to provide a completed asset.

Example 15—Manufacturing services versus manufactured equipment

Scenario 1—manufacturing services

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

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

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

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

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Example 15—Manufacturing services versus manufactured equipment

Scenario 2—manufactured equipment

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

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

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

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

B67 The following example illustrates a continuous transfer of services.

Example 16—Consulting services
On 1 January, an entity enters into a six-month fixed price contract with a customer to analyse the customer's historical sales trends in order to assist the customer in developing its budget. The entity promises to share findings with the customer each month and to provide the customer with a final report at the end of the contract. The customer promises to pay CU10,000 per month. The customer can change the specification of its requirements throughout the contract and has the right to obtain any analysis prepared by the entity. In this example, the terms of the contract and all the related facts and circumstances indicate that the customer has the ability to direct the use of, and receive the benefit from, the consulting services as they are performed. The customer has an unconditional obligation to pay throughout the contract as evidenced by the non-refundable progress payments. Additionally, the customer specifies the services to be provided throughout the contract and, hence, directs the nature of the services to be performed, which affects the entity's final report. Consequently, the entity's performance obligation is to provide the customer with services continuously during the six months of the contract.

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

Example 17—Sale of apartments
An entity is developing residential real estate and begins to market individual apartments during their construction. An entity enters into a contract with a customer for the sale of a specific apartment. The customer pays a deposit that is refundable only if the entity fails to deliver the completed apartment in accordance with the contract. The remainder of the purchase price is paid on completion of the contract when the customer obtains possession of the apartment. The customer is able to choose from a range of standardised options specified by the entity (for example, flooring, colour schemes and fixtures).
In this example, the terms of the contract and all the related facts and circumstances indicate that the customer obtains control of the apartment on completion of the contract. The customer obtains title and physical possession of the apartment only on completion of the contract. Additionally, the customer cannot specify major structural changes to the design of the apartment, which suggests that the apartment is not a customer-specific asset.
Consequently, the entity's performance obligation is to provide the customer with a completed apartment because the customer does not control the apartment until completion of the contract.

Customer acceptance

B69 Customer acceptance clauses are substantive contractual terms intended to ensure the customer's satisfaction with the goods or services promised in a contract. Without the customer's acceptance, the entity may not be entitled to consideration or may be required to take remedial action.

B70 An entity shall consider the effect of acceptance clauses in determining whether a customer has obtained control of a promised good or service.

B71 If an entity can objectively determine that a good or service has been transferred to the customer in accordance with the agreed specifications in the contract, then customer acceptance is a formality that would not affect an entity's determination of when the customer has obtained control of the good or service. For example, if the customer acceptance clause is based on meeting specified size and weight characteristics, an entity would be able to determine whether those criteria have been met before receiving the customer's acceptance. The entity's experience with contracts for similar goods or services may provide evidence that a good or service provided to the customer is in accordance with the agreed specifications in the contract. If revenue is recognised before customer acceptance, the entity must still consider whether there are any remaining performance obligations (for example, installation of equipment) and evaluate whether to account for them separately.

B72 If, however, an entity cannot objectively determine that the good or service provided to the customer is in accordance with the agreed specifications in the contract, then the entity would not be able to conclude that the customer has obtained control until the entity receives the customer's acceptance. That is because the entity cannot determine that the customer has the ability to direct the use of, and receive the benefit from, the good or service. For example, suppose an entity enters into a contract to provide one of its products, modified so that it can be integrated into the customer's new production line, and the customer's acceptance in the contract is subject to the customer's judgement of whether that product has been satisfactorily integrated. Further suppose that the entity has never previously modified its equipment in that way. In that case, the customer's written acceptance indicates the point at which the customer obtains control of the product.

B73 In some contracts, the effect of the acceptance clause is that an entity has delivered products to the customer for trial or evaluation purposes without the customer committing to pay any consideration. In some of those cases, the customer is contractually required to accept the product if it does not return it by a specified date. Hence, in those contracts the product has not been transferred to the customer until either the customer accepts the product or the specified date passes.

Determining the transaction price (paragraphs 35–49)

B74 Paragraph 35 requires an entity to determine the transaction price. An entity shall consider the effects of the following when determining the transaction price:

(a) variable consideration (paragraphs B75–B77);

(b) collectibility (paragraphs B78–B80);

(c) the time value of money (paragraphs B81–B84); and

(d) consideration payable to the customer (paragraph B85).

Variable consideration

B75 Paragraph 38 states that an entity shall recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated.

B76 The following example illustrates a situation in which part of the total consideration amount cannot be reasonably estimated.

Example 18—Management fees based on an index
On 1 January, an entity enters into a contract with a client to provide fund management services for one year. The customer is required to pay a fixed quarterly amount plus 10 per cent of any increase in the fund's value relative to an observable index at the end of the year. The entity has entered into many similar contracts previously. However, the entity determines that its experience with those types of contracts is not relevant to the contract because the circumstances surrounding those types of contracts could change significantly. The variable consideration amount is highly susceptible to external factors (market risk), the uncertainty is not expected to be resolved until the end of the year, and the contract has a large number of possible consideration amounts. Hence, the transaction price would be limited to the fixed amount of consideration until the end of the year.

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

Example 19—Consulting services with a performance bonus/ penalty

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

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

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

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

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

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

continued...

...continued **Example 19—Consulting services with a performance bonus/ penalty**
At contract inception, the consultant would allocate the transaction price of CU126,000 to the performance obligation to provide consulting services. Because those services are provided evenly over the six months, the consultant would recognise revenue of CU21,000 per month (CU126,000 ÷ 6 months). Because the client pays CU20,000 per month (CU1,000 less than the revenue recognised), the consultant would recognise a contract asset of CU1,000 in the first month to reflect the revenue recognised in excess of its unconditional rights to consideration. That contract asset would increase to CU3,000 by the end of the third month. After three months, the estimated transaction price decreases by CU4,000 (CU126,000 − CU122,000). Because half of the performance obligation has been satisfied (3 months ÷ 6 months), half of the CU4,000 decrease in the transaction price would be allocated to the satisfied performance obligation. Hence, the consultant would recognise revenue of CU61,000 for the first three months (CU122,000 × 3 months ÷ 6 months). The contract asset and revenue would decrease by CU2,000 (half of the CU4,000 decrease in the transaction price) at the time of the change in estimate. At the end of the contract, the transaction price becomes a fixed amount of CU130,000. Therefore, the consultant recognises revenue of CU8,000 (CU130,000 − CU122,000). If the consultant could not reasonably estimate the probability of each outcome during the contract, the transaction price would not include uncertain amounts. Hence, the transaction price would be CU110,000 until the uncertainty is resolved.

Collectibility

B78 In many contracts, the effect of the customer's credit risk on the transaction price is immaterial. In such cases, an entity measures the transaction price at the original invoice amount.

B79 However, in some contracts, although the contract satisfies the conditions in paragraph 10, there is a possibility that the customer might not pay the consideration for reasons other than the entity's non-performance. That includes situations in which an entity enters into contracts with customers and expects a proportion of them to default, but does not know which specific customers will default. In such contracts, paragraph 43 requires the entity to reduce the amount of promised consideration to reflect the possibility that it will not receive some or all of the promised consideration. Hence, the transaction price shall reflect the probability-weighted amount of consideration the entity expects to receive from the customer. If such an amount cannot be reasonably estimated in accordance with paragraph 38, no revenue shall be recognised until either cash is collected or an amount can be reasonably estimated.

Example 20—Customer credit risk
An entity enters into a contract with a customer to provide goods for CU1,000. Payment is due one month after the goods are transferred to the customer. The entity assesses, on the basis of its experience with contracts with similar characteristics, that there is a 10 per cent chance that the customer will not pay the consideration. Hence, the transaction price is CU900 [(90% × CU1,000) + (10% × CU0)]. When the entity transfers the goods to the customer and satisfies its performance obligation, it recognises a receivable and revenue of CU900. After transferring the goods to the customer, the financial condition of the customer deteriorates and the entity determines that the receivable due from that customer is further impaired by CU60. The entity recognises the impairment as an expense rather than as a reduction in revenue.

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

The time value of money

B81 Paragraph 44 requires an entity to adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component. In a contract with a material financing component, the amount of promised consideration comprises both of the following:

(a) the cash selling price of the goods or services at the point that they are transferred to the customer (assuming there is no discount to the cash selling price agreed with the customer for any other reason); and

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

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

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

Example 21—Customer payment in arrears
An entity sells a product to a customer for a CU10,000 payment due two years after the product is transferred to the customer. The entity determines that the discount rate in a financing transaction between the entity and the customer that did not involve the provision of other goods or services would be 6 per cent. When the entity transfers the product to the customer, it recognises revenue of CU8,900 [CU10,000 ÷ (1.06 × 1.06)]. The entity accounts for its unconditional rights to consideration (and interest) in accordance with IFRS 9 *Financial Instruments*.

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

Example 22—Customer payment in advance
An entity sells a product to a customer for a CU8,000 payment due one year before the product is transferred to the customer. On receipt of the customer's payment, the entity recognises a contract liability of CU8,000. The entity determines that the discount rate in a financing transaction between the entity and the customer that did not involve the provision of other goods or services would be 10 per cent. During the year before the product is transferred to the customer, the entity recognises interest expense of, and increases the measurement of the performance obligation by, CU800 [(CU8,000 × 1.10) − CU8,000]. Therefore, immediately before the performance obligation is satisfied the carrying amount of the contract liability is CU8,800 (CU8,000 + CU800). The entity recognises revenue of CU8,800 when it transfers the product to the customer.

Consideration payable to the customer

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

Example 23—Slotting fees
An entity sells 1,000 units of a product to a reseller for CU10,000. In addition, the entity pays CU1,000 to the reseller in exchange for a product placement service. That service includes specified services of stocking, displaying and supporting the products. The entity determines, on the basis of similar transactions in the marketplace, that the fair value of the product placement service is CU600. The entity must assess whether the CU1,000 payment to the customer is a reduction of the transaction price, a payment in exchange for a distinct good or a service, or a combination of both. Although the product placement service is not sold separately (ie without related products), the service is distinct because it has a distinct function and a distinct profit margin. Hence, the payment to the reseller for the product placement service would result in the entity recognising an expense in the amount of the fair value of the service (CU600). The remaining CU400 (CU1,000 payment to reseller − CU600 fair value of the service) would result in a reduction of the transaction price. The entity would recognise revenue of CU9,600 (CU10,000 − CU400) when the reseller obtains control of the products.

Example 24—Sales incentive
A manufacturer sells 1,000 units of a product to a retailer for CU8 per unit. The retailer sells the product direct to customers for CU10 per unit. The manufacturer issues coupons for a CU1 discount direct to customers via newspapers and flyers. The retailer accepts the coupons from customers and, thus, the customer pays CU10 per unit without a coupon or CU9 per unit with a coupon. The retailer submits all coupons to the manufacturer and receives CU1 per coupon submitted. At the time of transfer of products to the retailer, the manufacturer concludes that it cannot reasonably estimate the number of coupons to be redeemed. The manufacturer receives no distinct good or service in exchange for the coupons. Because the manufacturer cannot reasonably estimate the number of coupons to be redeemed, the transaction price is CU7,000 (CU8,000 less maximum discount of CU1,000) in accordance with paragraphs 38–41. If the manufacturer issues the coupons before it transfers the products to the retailer, it would recognise revenue of CU7,000 when the products are transferred to the retailer (in accordance with paragraph 49).

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

B86 Paragraph 50 requires an entity to allocate the transaction price to performance obligations in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations at contract inception. The following guidance illustrates how an entity would allocate the transaction price when an entity grants a customer an option to acquire additional goods or services that is determined to be a separate performance obligation as discussed in paragraphs B24–B26.

B87 The stand-alone selling price for a customer's option to acquire additional goods or services often is not directly observable and must be estimated. That estimate shall reflect the discount the customer would obtain when exercising the option, adjusted for the following:

(a) any discount that the customer could receive without exercising the option; and

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

Example 25—Estimating the stand-alone selling price of an option for additional goods or services
Consider again Example 5. The entity could estimate the stand-alone selling price of the discount voucher as follows. The entity estimates an 80 per cent likelihood that a customer will redeem the voucher and that a customer will, on average, purchase CU50 of additional products. Because the entity intends to offer a 10 per cent discount to all customers as part of a seasonal promotion, the 40 per cent discount that the customer would obtain when exercising the voucher needs to be reduced by 10 percentage points to 30 per cent to reflect the incremental value of the discount to the customer. Hence, the entity's estimated stand-alone selling price of the discount voucher is CU12 (CU50 average purchase of additional products × 30% incremental discount × 80% likelihood of exercising the option). If the stand-alone selling price of Product A is CU100, the entity allocates CU10.7 {CU100 × [12 ÷ (12 + 100)]} of the CU100 transaction price to the discount voucher.

Example 26—Customer loyalty programme
An entity has a customer loyalty programme that rewards a customer with one customer loyalty point for every CU10 of purchases. Each point is redeemable for a CU1 discount on any future purchases. During a reporting period, customers purchase products for CU100,000 and earn 10,000 points redeemable for future purchases. The stand-alone selling price of the purchased products is CU100,000. The entity expects 9,500 points to be redeemed. The entity estimates a stand-alone selling price of CU0.95 per point (or CU9,500 total) on the basis of the likelihood of redemption. The points provide a material right to customers that they would not receive without entering into a contract. Hence, the entity concludes that the points are a separate performance obligation. The entity allocates the transaction price to the product and the points on a relative stand-alone selling price basis as follows: Product CU91,324 (CU100,000 × CU100,000 ÷ CU109,500) Points CU8,676 (CU100,000 × CU9,500 ÷ CU109,500) *continued...*

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Example 26—Customer loyalty programme

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

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

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

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

(a) similar to the original goods or services in the contract; and

(b) provided in accordance with the terms of the original contract;

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

Example 27—Maintenance services with a renewal option

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

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

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

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

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

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

Year 1	CU600
Year 2	CU750
Year 3	CU1,000

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Example 27—Maintenance services with a renewal option

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

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

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

Contract costs (paragraphs 57–63)

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

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

Example 28—Outsourcing services with set-up activities

An entity enters into a contract to outsource a customer's information technology data centre for five years. The entity incurs selling commission costs of CU10,000 to obtain the contract. Before providing the services, the entity designs and builds a technology platform that interfaces with the customer's systems. That platform is not transferred to the customer.

The customer promises to pay a fixed fee of CU20,000 per month.

The CU10,000 costs of obtaining the contract are recognised as expenses when incurred.

The initial costs incurred to set up the technology platform are as follows:

Design services	CU40,000
Hardware and software	CU210,000
Migration and testing of data centre	CU100,000
Total	CU350,000

The initial set-up costs relate primarily to activities to fulfil the contract but do not transfer goods or services to the customer. The entity would account for the initial set-up costs as follows:

(a) Hardware costs—accounted for in accordance with IAS 16 *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—these costs would be considered for capitalisation in accordance with paragraph 57. Any resulting asset would be amortised as the entity provides the services outsourced by the customer.

Presentation (paragraphs 64–68)

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

Example 29—Presentation

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

Scenario 1—receivable

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

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

Dr receivable	CU1,000	
Cr revenue		CU1,000

On receiving the cash:

Dr cash	CU1,000	
Cr receivable		CU1,000

Scenario 2—contract liability and receivable

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

On obtaining an unconditional right to consideration on 31 January:

Dr receivable	CU1,000	
Cr contract liability		CU1,000

On receiving the cash on 15 February:

Dr cash	CU1,000	
Cr receivable		CU1,000

continued...

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Example 29—Presentation

On satisfying the performance obligation on 31 March:

Dr contract liability	CU1,000	
Cr revenue		CU1,000

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

Scenario 3—contract asset and receivable

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

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

On satisfying the performance obligation to transfer Product X:

Dr contract asset	CU400	
Cr revenue		CU400

On satisfying the performance obligation to transfer Product Y:

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

Disclosure (paragraphs 69–83)

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

Example 30—Relationship to disclosures provided by other IFRSs

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

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

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

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

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

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

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

Example 31—Inputs and assumptions used to estimate stand-alone selling prices
The entity's estimated stand-alone selling price for the software upgrade right included with Product X is CU100. The software upgrade right is specified in the contract but not sold separately. When estimating the stand-alone selling price of the software upgrade right, the entity considered the prices charged by the entity for upgrade rights provided with Product Y and the entity's historical pricing practices, including the relative selling prices of upgrades relative to the prices of the related products.

B95 In some cases, it may be relatively straightforward for an entity to disclose quantitative information about the inputs and assumptions used and their effect on the amount and timing of revenue recognition.

B96 In other cases, it may not be practicable to disclose quantitative information about the inputs and assumptions used and their effect on the amount and timing of revenue recognition because of the number of goods or services for which estimated prices are required. In those cases, an entity would describe its methods, inputs, assumptions and estimates. That description might include the following:

(a) the source of inputs (for example, observable market data, internally generated figures, or a mixture of the two);

(b) how often the inputs and assumptions are updated and the date of the latest update; and

(c) a description of how past experience and current conditions are taken into account in developing estimates and assumptions.

Appendix C
Amendments to other IFRSs

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

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

Standard	Description of amendment
• General	• Except where otherwise stated, references to 'IAS 18 *Revenue*' and 'IAS 11 *Construction Contracts*' are replaced with '[draft] IFRS X *Revenue from Contracts with Customers*'. • Except where otherwise stated, references to 'IAS 18' and 'IAS 11' are replaced with '[draft] IFRS X'.
• IAS 1 *Presentation of Financial Statements*	• Amend the references to existing IAS 18 revenue recognition requirements to be consistent with the proposals in the exposure draft.
• IAS 2 *Inventories*	• Delete paragraph 19 relating to 'cost of inventories of a service provider' and the corresponding reference in paragraph 8. Those costs would be accounted for in accordance with the requirements in paragraph 57 of [draft] IFRS X *Revenue from Contracts with Customers.* • Delete the scope exclusion for assets arising from 'construction contracts'.
• IAS 36 *Impairment of Assets*	• Amend the scope exclusion for 'assets arising from construction contracts' to 'assets arising under paragraph 57 of [draft] IFRS X *Revenue from Contracts with Customers*'.
• IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*	• Amend the scope exclusion for provisions arising from 'construction contracts' to provisions arising under 'paragraph 54 of [draft] IFRS X *Revenue from Contracts with Customers*'.
• IAS 38 *Intangible Assets*	• Add a scope exclusion for contract assets within the scope of [draft] IFRS X *Revenue from Contracts with Customers*.
• IAS 40 *Investment Property*	• Delete the scope exclusion in paragraph 9(b) for items arising from 'property being constructed or developed on behalf of third parties'.

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

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

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

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

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