

Applying IFRS

Joint Transition Group for
Revenue Recognition items of
general agreement

Updated December 2015

Contents

Overview	3
1. Step 1: Identify the contract(s) with a customer	4
1.1 Collectability	4
1.2 Contract enforceability and termination clauses	5
2. Step 2: Identify the performance obligations in the contract	7
2.1 Identification of performance obligations	7
2.2 Stand-ready obligations	7
2.3 Series of distinct goods and services	8
2.4 Gross versus net revenue - amounts billed to customers	10
2.5 Customer options for additional goods and services	10
3. Step 3: Determine the transaction price	15
3.1 Variable consideration	15
3.2 Portfolio practical expedient to estimate variable consideration	15
3.3 Accounting for restocking fees and related costs	16
3.4 Significant financing components	17
3.5 Consideration payable to a customer	18
4. Step 4: Allocate the transaction price to the performance obligations identified in the contract	20
4.1 Exceptions to the relative stand-alone selling price method	20
5. Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation	21
5.1 Determining when control of a commodity transfers	21
5.2 Measuring progress when multiple goods or services are combined in a single performance obligation	21
5.3 Practical expedient for measuring progress toward satisfaction of a performance obligation	23
5.4 Partial satisfaction of performance obligations prior to identifying the contract	24
6. Other measurement and recognition topics	25
6.1 Warranties	25
6.2 Pre-production activities	25
6.3 Incremental costs to obtain a contract	27
6.4 Impairment testing of capitalised contract costs	27
6.5 Contract assets and liabilities	28
7. Scope of the standards	30
7.1 Islamic financing transactions (this topic was raised in an IFRS context)	30
7.2 Determining the scope for certain credit card arrangements	30
7.3 Contributions (this topic was raised in a US GAAP context)	31
7.4 Gambling entities - fixed-odds wagering contracts (this topic was raised in a US GAAP context)	31

What you need to know

- ▶ The TRG has held six meetings since its inception to discuss a number of implementation issues. While no meetings are currently scheduled in 2016, the TRG may meet again if stakeholders continue to have broad implementation issues that they would like the TRG to address.
- ▶ During the discussions, TRG members reached general agreement on many topics, which are summarised in this publication.
- ▶ Although the views expressed by TRG members are non-authoritative, they represent the latest thinking on each topic; entities should consider these views as they implement the standards.

To help preparers implement the standards, the TRG has discussed numerous issues.

Overview

The International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) (collectively, the Boards) created the Joint Transition Resource Group for Revenue Recognition (TRG) to help them determine whether more application guidance is needed on their new revenue standards¹ and to educate constituents. TRG members include financial statement preparers, auditors and users from a variety of industries, countries and public and private entities. This publication summarises the issues on which members of the TRG generally agreed at meetings since the group was formed in 2014. TRG meetings are held jointly, with TRG members attending the meeting at the FASB's office in Norwalk, Connecticut or the IASB's office in London, except for the meeting on 30 March 2015 when technological difficulties required the discussions to be held separately. While no meetings are currently scheduled in 2016, the TRG may meet again if stakeholders continue to have broad implementation questions that they would like the TRG to address.

While any views expressed by the members of the TRG are non-authoritative, they represent the latest thinking on each topic, and entities should consider them as they implement the standards. Our summary, which is organised both by the steps within the standards' five-step model and by TRG discussion topic, is not intended to replace any summaries provided by the TRG or the Boards. For more information about these issues and those discussed by the TRG, but on which it did not reach general agreement, see our publications on TRG meetings, which are available on www.ey.com/ifrs.

¹ IFRS 15 *Revenue from Contracts with Customers*/Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (largely codified in Accounting Standards Codification (ASC) 606).

1. Step 1: Identify the contract(s) with a customer

1.1 Collectability

Under the standards, collectability refers to the customer's ability and intent to pay the amount of consideration to which the entity expects to be entitled. The Boards concluded that assessing a customer's credit risk is an important part of determining whether a contract, as defined by the standards, exists. If an arrangement does not meet the collectability criterion (or any of the other criteria) to be considered a contract under the standards, an entity can only recognise non-refundable consideration received as revenue when one of two events has occurred: (1) the entity has completed performance and received substantially all consideration; or (2) the contract has been terminated.

How would an entity assess collectability for a portfolio of contracts? [TRG meeting 26 January 2015 - Staff paper no. 13]

TRG members generally agreed that if an entity has determined it is probable that a specific customer will pay amounts owed under a contract, but the entity has historical experience that it will not collect consideration from some customers within a portfolio of contracts, it would be appropriate for the entity to record revenue for the specific contract in full and separately evaluate the corresponding contract asset or receivable for impairment.

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

When would an entity reassess collectability? [TRG meeting 26 January 2015 - Staff paper no. 13]

The standards require an entity to evaluate, at contract inception (and when significant facts and circumstances change), whether it is probable that it will collect the consideration to which it expects to be entitled (i.e., the transaction price, not the stated contract price). TRG members generally agreed that entities would need to exercise judgement to determine whether changes in the facts and circumstances require a reassessment of collectability. Judgement would also be needed to determine whether such changes are significant enough to indicate that a contract no longer exists under the standards.

How would an entity assess whether a contract includes a price concession? [TRG meeting 26 January 2015 - Staff paper no. 13]

The Boards indicated that an entity's belief that it will receive partial payment for performance may be sufficient evidence that an arrangement meets the definition of a contract (and that the expected shortfall of consideration is more akin to a price concession).

TRG members generally agreed that entities would need to exercise judgement. They also acknowledged that it may be difficult in some cases to distinguish between price concessions, impairment and a lack of sufficient commercial substance to be considered a contract under the standards.

The Boards have discussed some issues that were referred by the TRG.

While this topic was not on the TRG agenda, TRG members questioned whether the Boards intended to delay recognition of non-refundable cash consideration received in a number of situations indefinitely (e.g., a month-to-month service arrangement when the entity continues to perform). [TRG meeting 26 January 2015]

TRG members raised this issue in their discussion and generally agreed that the Boards' intent was not clear.

The IASB discussed this topic at its April 2015 meeting and decided not to make any clarifications or amendments to IFRS 15 in respect of the Step 1 collectability threshold. The IASB noted that sufficient guidance exists within IFRS 15 and in the explanatory material in the Basis for Conclusions.

In September 2015, the FASB proposed adding a third event that would trigger recognition of non-refundable consideration received as revenue when collectability is not probable (and, therefore, the arrangement cannot be accounted for as a contract under the standards). Under the proposal, an entity would recognise non-refundable consideration received as revenue if it has transferred control of the goods or services and has stopped transferring (and has no obligation to transfer) additional goods or services. This assessment would require judgement about the specific facts and circumstances (e.g., an entity's right to stop transferring goods or services may vary by arrangement or jurisdiction).

1.2 Contract enforceability and termination clauses

Under the standards, termination clauses are an important consideration when determining whether both parties are committed to perform under a contract and, consequently, whether a contract, as defined by the standards, exists.

How would termination clauses be evaluated in determining the duration of a contract (i.e., the contractual period)? [TRG meeting 31 October 2014 - Staff paper no. 10]

TRG members generally agreed with the conclusions reached in the examples included in the staff paper on this question. For example, if a contract with a stated contractual term can be terminated by either party at any time, for no consideration, TRG members generally agreed that the arrangement should be treated as a month-to-month contract, regardless of its stated contractual term.

TRG members also generally agreed that when a contract includes a substantive termination payment, the duration of the contract would equal the stated contractual term (or to the date when a termination payment would not be due).

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

TRG members generally agreed that a substantive termination penalty payable by a customer to the entity is evidence of enforceable rights and obligations of both parties throughout the period covered by the termination penalty. This is consistent with the general agreement the TRG reached in October 2014 that, when each party has the unilateral enforceable right to terminate the contract (at any time during a specified period) by compensating the other party, enforceable rights and obligations exist throughout the stated contractual term of the contract (or to the date when a termination payment would not be due). That is, members of the TRG do not view a customer-only right to terminate as sufficient to warrant a different conclusion.

For example, consider a four-year service contract in which the customer has the right to cancel without cause at the end of each year, but for which the customer would incur a termination penalty that decreases each year and is determined to be substantive. TRG members generally agreed that such an arrangement would be treated as a four-year contract.

TRG members also generally agreed with the conclusion in the staff paper, that customer cancellation rights would be treated as a customer option when there are no (or non-substantive) contractual penalties that compensate the other party upon cancellation and when the customer has the unilateral right to terminate the contract for reasons other than cause or contingent events outside the customer's control. The Boards noted, in the Basis for Conclusions of their respective standards, that a cancellation option or termination right is akin to a renewal option. That is, such a contract provision could be a performance obligation in the contract if it provides the customer with a material right.²

However, TRG members observed that the determination of whether a termination penalty is substantive, and what constitutes enforceable rights and obligations under a contract, will require judgement and consideration of the facts and circumstances.

² IFRS 15.BC391.

2. Step 2: Identify the performance obligations in the contract

2.1 Identification of performance obligations

To apply the new requirements, an entity must identify the promised goods and services within the contract and determine which of those goods and services are distinct (i.e., performance obligations).

Will the standards require the identification of promised goods or services that are not identified as deliverables today? [TRG meeting 26 January 2015 - Staff paper no. 12]

TRG members generally agreed that the standards are not intended to require the identification of promised goods or services that are not accounted for as separate deliverables today. Entities may not disregard items that they deem to be perfunctory or inconsequential and will need to consider 'free' goods and services. However, entities would consider materiality in determining whether items are promised goods or services. For example, telecommunications entities may have to allocate consideration to the 'free' handsets that they provide. Likewise, automobile manufacturers may have to allocate consideration to 'free' maintenance that may be considered a marketing incentive under current practice.

In October 2015, the FASB decided to amend its revenue standard to allow entities to disregard promises that are deemed to be immaterial in the context of the contract. The FASB's intent is to allow entities to disregard immaterial items at the contract level and not to require that they be aggregated and assessed for materiality at the entity level. The FASB will need to issue an ASU to finalise this amendment.

The IASB decided not to make any changes to the requirements in IFRS 15 in its exposure draft, issued on 30 July 2015, to avoid the risk of unintended consequences, since it believes the requirements are sufficiently clear and because there may be broader implications to consider beyond the revenue standard.

2.2 Stand-ready obligations

The standards state that a contract may include "a service of standing ready to provide goods or services (e.g., unspecified updates to software that are provided on a when-and-if-available basis) or of making goods or services available for a customer to use as and when the customer decides."³

What is the nature of the promise in a 'typical' stand-ready obligation? [TRG meeting 26 January 2015 - Staff paper no. 16]

TRG members generally agreed that the promise in a stand-ready obligation is the assurance that the customer will have access to the good or service, not the delivery of the underlying good or service.

³ IFRS 15.26(e).

Stakeholders raised this question in the context of several types of arrangements, including transactions for software or technology that provide a customer with a right to future upgrades. A FASB staff member indicated that the staff does not believe that the FASB intended to change current practice under US GAAP for determining when software or technology transactions include specified upgrade rights (i.e., a separate performance obligation) or unspecified upgrade rights (i.e., a stand-ready obligation).

How would an entity measure progress towards satisfaction of a stand-ready obligation that is satisfied over time? [TRG meeting 26 January 2015 - Staff paper no. 16]

TRG members generally agreed that an entity should not default to a straight-line revenue attribution model. However, if an entity expects the customer to receive and consume the benefits of its promise throughout the contract period, a time-based measure of progress (e.g., straight-line) would be appropriate. A FASB staff member indicated that this may often be the case for unspecified upgrade rights. TRG members generally agreed that rateable recognition may not be appropriate if the benefits are not spread evenly over the contract period (e.g., an annual snow removal contract that provides more benefit in winter).

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

TRG members generally agreed that not all contracts with a stand-ready element necessarily include a single performance obligation satisfied over time. As an example, an entity may be required to stand ready to produce a part for a customer under a master supply arrangement (MSA). If the nature of the promise is a service of standing ready, the contract would be accounted for as a single performance obligation satisfied over time. In that situation, the entity may be required to estimate the number of purchases to be made throughout the contract term and continually update the transaction price and its allocation among the transferred goods and services. However, TRG members generally agreed that the nature of the promise in this example is the delivery of the parts, rather than a service of standing ready. When the customer submits a purchase order under the MSA, it is contracting for a specific number of distinct goods and creates new performance obligations for the entity.

2.3 Series of distinct goods and services

The standards require that a series of distinct goods or services be accounted for as a single performance obligation if they are substantially the same, have the same pattern of transfer and both of the following criteria are met: (1) each distinct good or service in the series represents a performance obligation that would be satisfied over time; and (2) the entity would measure its progress towards satisfaction of the performance obligation using the same measure of progress for each distinct good or service in the series (the series requirement). Entities will need to determine whether a single performance obligation is created as a result of applying the series requirement, in order to allocate variable consideration appropriately and apply the contract modification and changes in transaction price requirements.

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

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

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

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

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

TRG members generally agreed that the staff paper on this question, which primarily focused on the application of the series provision to service contracts, will help entities understand the new revenue standards' requirement to determine whether a performance obligation consists of distinct goods or services that are 'substantially the same'.

In the staff paper, the first step is to determine the nature of the entity's promise in providing services to the customer. That is, if the nature of the promise is to deliver a specified quantity of service (e.g., monthly payroll services over a defined contract period), the evaluation would consider whether each service is distinct and substantially the same. By contrast, if the nature of the entity's promise is to stand-ready or provide a single service for a period of time (i.e., because there is an unspecified quantity to be delivered), the evaluation would consider whether each time increment (e.g., hour or day), rather than the underlying activities, is distinct and substantially the same.

The evaluation in the staff paper is consistent with the examples in the new revenue standards on monthly payroll processing and hotel management services, respectively. In the monthly payroll processing example, the nature of the promise is to deliver 12 distinct instances of the service that are substantially the same over the course of one year. In the hotel management example, the nature of the promise is to provide a daily management service. The underlying activities could vary within a day and from day to day (e.g., employee management, training or accounting services), but that would not prevent an entity from concluding that the daily management service is distinct and substantially the same.

2.4 Gross versus net revenue - amounts billed to customers

Under the standards, an entity is required to determine whether the nature of its promise is to provide the specified goods or services itself (i.e., the entity is a principal) or to arrange for another party to provide those goods or services (i.e., the entity is an agent). Furthermore, the standards require that any “amounts collected on behalf of third parties (for example, some sales taxes)” be excluded from the transaction price.⁴

How would entities determine the presentation of amounts billed to customers (e.g., shipping and handling, reimbursement of out-of-pocket expenses and taxes) under the standards (i.e., as revenue or as a reduction of costs)? [TRG meeting 18 July 2014 - Staff paper no. 2]

TRG members generally agreed that the standards are clear that any amounts not collected on behalf of third parties would be included in the transaction price (i.e., revenue). That is, if the amounts were incurred by the entity in fulfilling its performance obligations, the amounts will be included in the transaction price and recorded as revenue.

Several TRG members noted that this would require entities to evaluate taxes collected in all jurisdictions in which they operate to determine whether a tax is levied on the entity or the customer. TRG members generally agreed that an entity would apply the principal versus agent application guidance when it is not clear whether the amounts are collected on behalf of third parties. This could result in amounts billed to a customer being recorded as an offset to costs incurred (i.e., on a net basis), even when the amounts are not collected on behalf of third parties.

In September 2015, the FASB proposed allowing an entity to make an accounting policy choice to present revenue net of certain types of taxes collected from a customer, including sales, use, value-added and some excise taxes, if it discloses its policy. The FASB's decision was to address a concern expressed by stakeholders in the US as to the operability of the requirements under US GAAP. The IASB decided that such an accounting policy choice is not necessary in IFRS 15 as the topic is not an interpretative question and is consistent with current IFRS requirements.⁵ Therefore, the IASB did not include a similar accounting policy choice in its exposure draft issued on 30 July 2015.

2.5 Customer options for additional goods and services

The standards specify that when an entity grants a customer the option to acquire additional goods or services (e.g., future sales incentives, loyalty programmes or renewal options), that option is a separate performance obligation if it provides a material right to the customer that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market).⁶

⁴ IFRS 15.47.

⁵ IAS 18.8.

⁶ IFRS 15.B40.

Should entities consider only the current transaction or should they consider past and future transactions with the same customer when determining whether an option for additional goods and services provides the customer with a material right? [TRG meeting 31 October 2014 – Staff paper no. 6]

TRG members generally agreed that entities should consider accumulating incentives in programmes (e.g., loyalty programmes) when determining whether an option represents a material right. That is, they do not believe the evaluation should be performed only in relation to the current transaction.

Is the material right evaluation solely a quantitative evaluation or should the evaluation also consider qualitative factors? [TRG meeting 31 October 2014 – Staff paper no. 6]

TRG members generally agreed that the evaluation should consider both quantitative and qualitative factors (e.g., what a new customer would pay for the same service, the availability and pricing of competitors' service alternatives, or whether the average customer life indicates that the fee provides an incentive for customers to remain beyond the stated contract term).

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

Some TRG members agreed that it would be reasonable for an entity to apply the requirements for contract modifications to the exercise of a material right. This conclusion primarily focuses on the definition of a contract modification (i.e., a change in the scope or price, or both, of a contract). However, many TRG members favoured an approach that would treat the exercise of a material right as a continuation of the existing contract (and not a contract modification) because an option to purchase additional goods or services is contemplated in the original contract (and not as part of a separate and subsequent negotiation). TRG members generally agreed that the exercise of a material right would not be treated as variable consideration, but as either a contract modification or a continuation of the existing contract. TRG members discussed and agreed that an entity would need to consider which approach is most appropriate, depending on the facts and circumstances and consistently apply that approach to similar contracts.

Is an entity required to evaluate whether a customer option that provides a material right includes a significant financing component? If so, how would entities perform this evaluation? [TRG meeting 30 March 2015 – Staff paper no. 32]

TRG members generally agreed that an entity will have to evaluate whether a material right includes a significant financing component, in the same way as it would evaluate any other performance obligation. This evaluation will require judgement and consideration of the facts and circumstances.

On this question, the staff paper discussed a factor that may be determinative in this evaluation. The standards indicate that if a customer provides advance payment for a good or service, but the customer can choose when the good or service is transferred, no significant financing component exists. As a result, if the customer can choose when to exercise the option, there may not be a significant financing component.

Both qualitative and quantitative factors would need to be considered in assessing if there is a material right.

Over what period should an entity recognise a non-refundable upfront fee (e.g., fees paid for membership to a club, activation fees for phone, cable or internet services) that does not relate to the transfer of a good or service? [TRG meeting 30 March 2015 – Staff paper no. 32]

TRG members generally agreed that the period over which a non-refundable upfront fee will be recognised depends on whether the fee provides the customer with a material right with respect to future contract renewals. For example, assume that an entity charges a one-time activation fee of CU50 to provide CU100 of services to a customer on a month-to-month basis. If the entity concludes that the activation fee provides a material right, the fee would be recognised over the estimated customer life (e.g., two years) because that represents the period of benefit for the activation fee. If the entity concludes that the activation fee does not provide a material right, the fee would be recognised over the contract term (i.e., one month).

How should an entity distinguish between a contract that contains an option to purchase additional goods and services and a contract that includes variable consideration based on a variable quantity (e.g., a usage-based fee)? [TRG meeting 9 November 2015 – Staff paper no. 48]

TRG members generally agreed that this determination requires judgement and consideration of the facts and circumstances. They also generally agreed that the staff paper on this question provides a framework that will help entities to make this determination.

The staff paper explained that the first step for the entity in determining whether a contract includes optional purchases or variable consideration is to determine the nature of the entity's promise in providing services to the customer and the rights and obligations of each party. With a customer option, the vendor is not obligated to provide additional goods and services until the customer exercises the option. In contrast, in a contract that includes variable consideration (rather than a customer option), the vendor is presently obligated to transfer all goods and services requested by the customer.

The staff paper contains the following example of a contract that includes a customer option (rather than variable consideration): Entity B enters into a contract to provide 100 widgets to Customer Y at CU10 per widget. Each widget is a distinct good transferred at a point in time. The contract also gives Customer Y the right to purchase additional widgets at the stand-alone selling price of CU10 per widget. Therefore, the quantity that may be purchased by Customer Y is variable.

The staff paper concludes that, while the quantity of widgets that may be purchased is variable, the transaction price for the existing contract is fixed at CU1,000 [100 widgets x CU10/widget]. That is, the transaction price only includes the consideration for the 100 widgets specified in the contract. Any exercise of an option for additional widgets would be accounted for as a separate contract (because there is no material right, given the pricing of the option at the stand-alone selling price of the widget). While Entity B may be required to deliver additional widgets in the future, Entity B is not legally obligated to provide the additional widgets until Customer Y exercises the option.

Examples described in the staff paper of contracts that may include variable consideration (rather than a customer option) included certain information technology outsourcing and transaction processing contracts. Under these types of contracts, the vendor provides continuous delivery of a service over the contract term.

How should an entity account for a customer's option to purchase or use additional copies of software? [TRG meeting 9 November 2015 - Staff paper no. 45]

TRG members considered examples of vendors that enter into multi-year software arrangements with customers for a fixed fee of CU300,000 for up to 500 users. The customers pay CU400 for each additional user. In some fact patterns, the customers may be able to replicate the software without the assistance of the vendor. In other fact patterns, the customers must request additional access codes from the vendor.

TRG members generally agreed that the entity would have to determine whether the contract is for a single licence or for multiple licences and that this determination requires judgement and consideration of the facts and circumstances.

TRG members also generally agreed that an entity would have to perform a similar analysis to that discussed in staff paper no. 48 above, in order to determine whether the additional software usage represents an option to purchase additional goods and services or variable consideration based on a variable quantity (e.g., a usage-based fee). In addition, they generally agreed that the accounting should not depend on whether the customer needs the vendor's assistance to receive the additional software licences.

If the customer's ability to add users is treated as a customer option, the vendor would have to determine at contract inception whether the option represents a material right. If it is a material right, the vendor would allocate a portion of the transaction price to it. If the option is not a material right, the vendor would not account for the additional purchases until they occur. If the customer's ability to add users is considered variable consideration (because it represents additional usage of the software that the customer already controls and, therefore, additional consideration), revenue would be recognised when (or as) the additional purchases occur.

When, if ever, should an entity consider the goods or services underlying a customer option as a separate performance obligation when there are no contractual penalties (e.g., termination fees, monetary penalties for not meeting contractual minimums)? [TRG meeting 9 November 2015 - Staff paper no. 48]

TRG members generally agreed that, even if an entity believes that it is virtually certain that a customer will exercise its option for additional goods and services, it would not identify the additional goods and services underlying the option as promised goods or services (or performance obligations) if there are no contractual penalties. Only the option would be assessed to determine whether it represents a material right to be accounted for as a performance obligation. As a result, consideration that would be received in return for optional goods or services is not included in the transaction price at contract inception.

The staff paper contained an example of a contract in which an entity sells equipment and consumables and both are determined to be distinct goods that are recognised at a point in time. The stand-alone selling price of the equipment and each consumable is CU10,000 and CU100, respectively. The equipment costs CU8,000 and each consumable costs CU60. The entity sells the equipment for CU6,000 (i.e., at a 40% discount on its stand-alone selling price) with a customer option to purchase each consumable for CU100 (i.e., equal to its stand-alone selling price). There are no contractual minimums, but the entity estimates the customer will purchase 200 parts over the next two years. This is an exclusive contract in which the customer cannot purchase the consumables from any other vendors during the contract term.

TRG members generally agreed that the consumables underlying each option would not be considered a part of the contract. Furthermore, the option does not represent a material right because it is priced at the stand-alone selling price for the consumable. Accordingly, the transaction price is CU6,000 and it is entirely attributable to the equipment. This would result in a loss for the entity of CU2,000 when it transfers control of the equipment to the customer.

3. Step 3: Determine the transaction price

3.1 Variable consideration

Under the new standards, if the consideration promised in a contract includes a variable amount, an entity will be required to estimate the amount of consideration to which it will be entitled in exchange for transferring the promised goods or services to a customer. Variability can result from discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. Entities will be required to constrain the amount of variable consideration included in the estimated transaction price. That is, they will have to conclude that it is highly probable (probable)⁷ that a significant revenue reversal will not occur in future periods before including any such amounts in the transaction price.

If a contract includes an undefined quantity of outputs, but the contractual rate per unit is fixed, is the consideration variable? [TRG meeting 13 July 2015 - Staff paper no. 39]

TRG members generally agreed that if a contract includes an unknown quantity of tasks, throughout the contract period, for which the entity has enforceable rights and obligations and the consideration received is contingent upon the quantity completed, the total transaction price would be variable. This is because the contract has a range of possible transaction prices and the ultimate consideration will depend on the occurrence or non-occurrence of a future event (e.g., customer usage), even though the rate per unit is fixed.

The staff paper on this question noted that an entity would need to consider contractual minimums (or other clauses) that would make some or all of the consideration fixed.

Would the constraint on variable consideration be applied at the contract or performance obligation level? [TRG meeting 26 January 2015 - Staff paper no. 14]

TRG members generally agreed that the constraint would be applied at the contract level and not at the performance obligation level. That is, the significance assessment of the potential revenue reversal would consider the total transaction price of the contract (and not the portion of transaction price allocated to a performance obligation).

3.2 Portfolio practical expedient to estimate variable consideration

The new revenue standards state that an entity can account for a portfolio of similar contracts collectively if it expects that the result will not be materially different from the result of applying the requirements to the individual contracts.

In addition, an entity must determine whether to use an 'expected value' or a 'most likely amount' method to estimate the amount of variable consideration to

⁷ The FASB's standard uses the term 'probable', which is intended to have the same meaning as 'highly probable' under IFRS.

The constraint on variable consideration would be applied at the contract level.

include in the transaction price, based on the method that better predicts the amount of consideration to which it will be entitled.

Is an entity applying the portfolio practical expedient when it considers evidence from other similar contracts to develop an estimate of variable consideration using an expected value method? [TRG meeting 13 July 2015 - Staff paper no. 38]

TRG members generally agreed that an entity is not applying the portfolio practical expedient when considering evidence from other similar contracts to develop an estimate of variable consideration using an expected value method. An entity could choose to apply the portfolio practical expedient, but it is not required to do so.

3.3 Accounting for restocking fees and related costs

Entities sometimes charge customers a 'restocking fee' when a product is returned. This fee may be levied by entities to compensate them for the costs of repackaging, shipping and/or reselling the item at a lower price to another customer. Stakeholders have raised questions about how to account for restocking fees and related costs. Under the new revenue standards, rights of return create variability in the transaction price. An entity is required to estimate the amount of expected returns at contract inception, exclude this amount from its transaction price and establish a corresponding refund liability. An entity will also recognise a return asset (and adjust cost of sales) for the right to recover the goods returned by the customer.

How should an entity account for restocking fees for goods that are expected to be returned? [TRG meeting 13 July 2015 - Staff paper no. 35]

TRG members generally agreed that restocking fees for goods that are expected to be returned would be included in the estimate of the transaction price at contract inception and recorded as revenue when (or as) control of the good transfers.

For example, assume that an entity enters into a contract with a customer to sell 10 widgets for CU100 each. The customer has the right to return the widgets, but if it does so, it will be charged a 10% restocking fee (or CU10 per returned widget). The entity estimates that 10% of all widgets that are sold will be returned. Upon transfer of control of the 10 widgets, the entity will recognise revenue of CU910 [(9 widgets not expected to be returned x CU100 selling price) + (1 widget expected to be returned x CU10 restocking fee)]. A refund liability of CU90 will also be recorded [1 widget expected to be returned x (CU100 selling price - CU10 restocking fee)].

How should an entity account for restocking costs related to expected returns (e.g., shipping or repackaging costs)? [TRG meeting 13 July 2015 - Staff paper no. 35]

TRG members generally agreed that restocking costs would be recorded as a reduction of the amount of the return asset when (or as) control of the good transfers. This accounting treatment will be consistent with the new revenue standards' requirement that the return asset be initially measured at the former carrying amount of the inventory, less any expected costs to recover the goods (e.g., restocking costs).

3.4 Significant financing components

Under the standards, an entity is required to assess whether a contract contains a significant financing component if it receives consideration more than one year before or after it transfers goods or services to the customer (e.g., the consideration is prepaid or is paid after the goods or services are provided).

The standards state that a significant financing component does not exist if the difference between the promised consideration and the cash selling price of the good or service arises for reasons other than the provision of finance. Should this factor be broadly or narrowly applied? [TRG meeting 30 March 2015 - Staff paper no. 30]

TRG members generally agreed that there will likely be significant judgement involved in determining whether a significant financing component exists. TRG members also generally agreed that the Boards did not seem to intend to imply that there is a presumption that a significant financing component exists if the cash selling price differs from the promised consideration or, conversely, that a significant financing component does not exist simply because an advance payment is received from the customer. TRG members generally agreed that, while there may be valid non-financing reasons for advance payments, the standards do not exclude advance payments from the requirements on significant financing components. As a result, it is important that entities analyse all of the facts and circumstances in a contract.

The standards state that an entity must consider the difference, if any, between the amount of promised consideration and the cash selling price of a promised good or service when determining whether a significant financing component exists in a contract. If the promised consideration is equal to the cash selling price, does a financing component exist? [TRG meeting 30 March 2015 - Staff paper no. 30]

TRG members generally agreed that, even if the list price, cash selling price and promised consideration of a good or service are all equal, an entity should not automatically assume that there is no significant financing component. This would be a factor to consider, but would not be determinative.

Do the standards preclude accounting for financing components that are not significant? [TRG meeting 30 March 2015 - Staff paper no. 30]

TRG members generally agreed that the standards do not preclude an entity from deciding to account for a financing component that is not significant. In addition, an entity electing to apply the requirements for significant financing components to an insignificant financing component needs to be consistent in its application to all similar contracts with similar circumstances.

The standards include a practical expedient that allows an entity not to assess a contract for a significant financing component if the period between the customer's payment and the entity's transfer of the goods or services is one year or less. How should entities consider whether the practical expedient applies to contracts with a single payment stream for multiple performance obligations? [TRG meeting 30 March 2015 - Staff paper no. 30]

TRG members generally agreed that entities will either: (1) apply any consideration received to the earliest good or service delivered; or (2) allocate it proportionately between the goods and services depending on the facts and circumstances.

The staff paper on this question provided an example of a telecommunications entity that enters into a two-year contract to provide a device at contract inception and related data services over 24 months in exchange for 24 equal monthly instalments. The approach under (1) would allow the entity to apply the practical expedient because the period between transfer of the good or service and customer payment would be less than one year for both the device and the related services. The approach under (2) would not allow an entity to apply the practical expedient because the device would be deemed to be paid off over the full 24 months (i.e., greater than one year).

TRG members generally agreed that the approach under (2) above may be appropriate in circumstances similar to the example in the staff paper, when the cash payment is not directly tied to the earliest good or service delivered in a contract. However, the approach under (1) above may be appropriate when the cash payment is directly tied to the earliest good or service delivered.

If a significant financing component exists in a contract, how should an entity calculate the adjustment to revenue? [TRG meeting 30 March 2015 - Staff paper no. 30]

TRG members generally agreed that the standards do not contain requirements on how to calculate the adjustment to the transaction price due to a financing component. A financing component will be recognised as interest expense (when the customer pays in advance) or interest income (when the customer pays in arrears). Entities need to consider requirements outside the revenue standards to determine the appropriate accounting treatment (i.e., IFRS 9 *Financial Instruments*/IAS 39 *Financial Instruments: Recognition and Measurement* or Accounting Standards Codification (ASC) 835-30, *Interest – Imputation of Interest*).

How should an entity allocate a significant financing component when there are multiple performance obligations in a contract? [TRG meeting 30 March 2015 - Staff paper no. 30]

TRG members noted that it may be difficult to require allocation to specific performance obligations because cash is fungible, but it may be reasonable for entities to apply other requirements in the standards to allocate variable consideration and/or discounts to one or more (but not all) performance obligations, if specified criteria are met.

3.5 Consideration payable to a customer

The new revenue standards require that an entity account for consideration payable to a customer (e.g., cash, credit or other items, such as coupons or vouchers, that can be applied against amounts owed to the entity) as a reduction of revenue, unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the entity.

Which payments to a customer are in the scope of the requirements for consideration payable to a customer? [TRG meetings 30 March 2015 - Staff paper no. 28; and 13 July 2015 - Staff paper no. 37]

TRG members generally agreed that an entity may not need to analyse each payment to a customer separately if it is apparent that the payment is for a distinct good or service acquired in the normal course of business at market prices. However, if the business purpose of a payment to a customer is unclear, or the goods or services are acquired in a manner that is inconsistent with market terms that other entities would receive when purchasing the customer's goods or services, the payment needs to be evaluated under these requirements.

Who is considered to be an entity's customer when applying the requirements for consideration payable to a customer? [TRG meetings 30 March 2015 - Staff paper no. 28; and 13 July 2015 - Staff paper no. 37]

TRG members generally agreed that the requirements for consideration payable to a customer would be applied to all payments made to entities/customers in the distribution chain of a contract. However, they agreed there could also be situations in which the requirements would apply to payments made to any customer of an entity's customer outside the distribution chain if both parties are considered to be the entity's customers. For example, in an arrangement with a principal, an agent and an end-customer, an agent may conclude its only customer is the principal, or it may conclude that it has two customers – the principal and the end-customer. TRG members generally agreed that agents will need to evaluate their facts and circumstances to determine whether payments made to an end-customer would be considered a reduction of revenue or a marketing expense.

How do the requirements on the timing of recognition of consideration payable to a customer reconcile with the variable consideration requirements? [TRG meetings 30 March 2015 - Staff paper no. 28; and 13 July 2015 - Staff paper no. 37]

TRG members generally agreed that the standards contain potentially conflicting requirements on when to recognise consideration payable to a customer that involves variable payments (e.g., price concessions). Under the requirements for when to recognise consideration payable to a customer, any reduction of the transaction price (and, therefore, of revenue) will be recognised at the later of when the entity transfers the promised goods or services to the customer or the entity promises to pay the consideration. However, if an entity has a history of providing this type of consideration to its customers, the requirements for estimating variable consideration require the entity to consider such amounts at the contract's inception when the transaction price is estimated, even if the entity has not yet provided or promised to provide this consideration to the customer. Some TRG members also noted that this conflict may not arise frequently.

4. Step 4: Allocate the transaction price to the performance obligations identified in the contract

4.1 Exceptions to the relative stand-alone selling price method

Under the standards' relative stand-alone selling price method, a contract's transaction price will be allocated proportionately to all performance obligations identified in a contract, with two exceptions. One exception requires variable consideration to be allocated entirely to a specific part of a contract, such as one or more (but not all) performance obligations in the contract, or one or more (but not all) distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation. Two criteria must be met to apply this exception. Firstly, the terms of the variable payment must relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service. Secondly, allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service must be consistent with the new revenue standards' allocation objective.

Since some discounts will also meet the definition of variable consideration (i.e., a discount that is variable in amount and/or contingent on future events), which exception would an entity apply? [TRG meeting 30 March 2015 - Staff paper no. 31]

TRG members generally agreed that, under the standards, an entity will first determine whether a variable discount meets the variable consideration exception. If it does not, the entity will then consider whether it meets the discount exception. However, if the discount is not variable (i.e., the amount of the discount is fixed and not contingent on future events), it would only be evaluated under the discount exception.

In order to meet the criteria to allocate variable consideration entirely to a specific part of a contract, must the allocation be made on a relative stand-alone selling price basis? [TRG meeting 13 July 2015 - Staff paper no. 39]

TRG members generally agreed that a relative stand-alone selling price allocation is not required to meet the allocation objective when it relates to the allocation of variable consideration to a specific part of a contract (e.g., a distinct good or service in a series). The Basis for Conclusions for the new revenue standards notes that stand-alone selling price is the default method for meeting the allocation objective, but other methods could be used in certain instances (e.g., in allocating variable consideration).⁸

⁸ IFRS 15.BC279-BC280.

5. Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

5.1 Determining when control of a commodity transfers

Under the new revenue standards, an entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of three criteria is met. The first criterion to determine whether control of a good or service transfers over time is that the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs. For a commodity, this evaluation is important in determining whether the sale of a commodity will meet the criteria to be treated as a series of distinct goods or services (and, therefore, as a single performance obligation). This, in turn, affects how an entity will allocate variable consideration and apply the requirements for contract modifications and changes in the transaction price.

What factors should an entity consider when evaluating whether a customer simultaneously receives and consumes the benefits of a commodity (e.g., electricity, natural gas or heating oil) as the entity performs? [TRG meeting 13 July 2015 - Staff paper no. 43]

TRG members generally agreed that an entity would consider all known facts and circumstances when evaluating whether a customer simultaneously receives and consumes the benefits of a commodity. These may include the inherent characteristics of the commodity (e.g., whether the commodity can be stored), contract terms (e.g., a continuous supply contract to meet immediate demands) and information about infrastructure or other delivery mechanisms.

Therefore, revenue related to the sale of a commodity may or may not be recognised over time, depending on whether the facts and circumstances of the contract indicate that the customer will simultaneously receive and consume the benefits. This evaluation will likely require the use of significant judgement.

5.2 Measuring progress when multiple goods or services are combined in a single performance obligation

When an entity has determined that a performance obligation is satisfied over time, the standards require the entity to select a single measure of progress that best depicts the entity's performance in transferring the goods or services in order to recognise revenue as the entity performs. The standards provide two methods for measuring progress: (1) an input method (e.g., resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used); and (2) an output method (e.g., surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed, units produced or units delivered).

Can multiple measures of progress be used to depict an entity's performance in transferring a performance obligation comprised of two or more goods and/or services that is satisfied over time? Under Step 2 of the new model, a single performance obligation may contain multiple non-distinct goods or services, and/or distinct goods or services that were required to be combined with non-distinct goods or services in order to identify a distinct bundle. This bundled performance obligation is referred to as a 'combined performance obligation' for the purpose of this discussion. [TRG meeting 13 July 2015 - Staff paper no. 41]

TRG members generally agreed that, when an entity has determined that a combined performance obligation is satisfied over time, the entity has to select a single measure of progress that best depicts the entity's performance in transferring the goods or services. While TRG members did not discuss this point, the staff paper noted that a single method of measuring progress should not be broadly interpreted to mean an entity may apply multiple measures of progress as long as all measures used are either output or input measures. TRG members also acknowledged that there is currently diversity in practice, and selecting a single measure of progress may represent a change for entities that currently use a multiple attribution model when deliverables cannot be separated into different units of account.

How should an entity determine the appropriate single measure of progress for a combined performance obligation that is satisfied over time? [TRG meeting 13 July 2015 - Staff paper no. 41]

TRG members acknowledged that it may be difficult to appropriately determine a single measure of progress when the entity will transfer goods or services that make up the combined performance obligation over different points of time, and/or the entity would otherwise use a different measure of progress (e.g., a time-based method versus a labour-based input method), if each promise is a separate performance obligation. Such a determination will require significant judgement, but TRG members generally agreed that the measure of progress selected is not meant to be a 'free choice', nor should entities default to an approach for determining a single measure of progress. For example, entities should not default to a 'final deliverable' methodology such that all revenue would be recognised over the performance period of the last promised good or service. Rather, an entity is required to select the single measure of progress that most accurately depicts the entity's performance in satisfying its combined performance obligation.

Some TRG members observed that an entity would need to consider the reasons why goods or services were bundled into a combined performance obligation in order to determine the appropriate pattern of revenue recognition. For example, if a good or service was combined with other goods or services because it was not capable of being distinct, that may indicate that it does not provide value or use to the customer on its own. Therefore, the entity would not contemplate the transfer of that good or service when determining the pattern of revenue recognition for the combined performance obligation.

TRG members also generally agreed that, if an appropriately selected single measure of progress does not faithfully depict the economics of the arrangement, the entity should challenge whether the performance obligation was correctly combined (i.e., there may be more than one performance obligation).

5.3 Practical expedient for measuring progress toward satisfaction of a performance obligation

The new revenue standards include a practical expedient that allows an entity to recognise revenue in the amount for which it has the right to invoice (i.e., the 'right to invoice' practical expedient) if the entity has a right to payment from a customer in an amount that corresponds directly with the value of the entity's performance completed to date (e.g., a service contract in which an entity bills a fixed amount for each hour of service provided). In addition, the Boards provided a practical expedient under which an entity can choose not to disclose certain information. For contracts for which revenue is recognised in accordance with the 'right to invoice' practical expedient or contracts that have an expected duration of less than one year, an entity can choose not to disclose the amount of transaction price allocated to remaining performance obligations (similar to 'backlog' disclosures).

Can an entity use the 'right to invoice' practical expedient for a contract that includes rates that change over the contractual term? [TRG meeting 13 July 2015 - Staff paper no. 40]

TRG members generally agreed that determining whether an entity can apply the 'right to invoice' practical expedient will require judgement. They also generally agreed that it is possible for entities to meet the requirements for the practical expedient in contracts with changing rates, provided that the changes correspond directly to changes in value to the customer. That is, a contract does not need to have a fixed price per unit for the duration of the contract in order to qualify for the practical expedient. Examples of contracts that might qualify include an IT outsourcing arrangement with rates that decrease over the contract term as the level of effort to the customer decreases, or a multi-year electricity contract that contemplates the forward market price of electricity. However, the Securities and Exchange Commission (SEC) Observer noted that entities will need to have strong evidence that variable prices are representative of value to the customer in order to recognise variable amounts of revenue for similar goods or services.

TRG members also discussed that an entity would have to evaluate all significant upfront payments or retrospective adjustments (e.g., accumulating rebates) in order to determine whether the amount the entity has a right to invoice for each incremental good or service corresponds directly to the value to the customer. That is, if an upfront payment or retrospective adjustment shifts payment for value to the customer to the front or back-end of a contract, it may be difficult for an entity to conclude that the amount invoiced corresponds directly with the value provided to the customer for goods or services.

The staff paper on this question also stated that the presence of an agreed customer payment schedule does not mean that the amount an entity has the right to invoice corresponds directly with the value to the customer of the entity's performance completed to date. In addition, the staff paper stated that the existence of specified contract minimums (or volume discounts) would not always preclude the application of the practical expedient, provided that these clauses are deemed non-substantive (e.g., the entity expects to receive amounts in excess of the specified minimums).

If an entity determines that it has not met the criteria to use the 'right to invoice' practical expedient (e.g., because there is a substantive contractual minimum payment or a volume discount), can the entity still use the 'backlog' practical expedient? [TRG meeting 13 July 2015 - Staff paper no. 40]

TRG members generally agreed that the standards are clear that an entity can only use the 'backlog' practical expedient to avoid disclosing the amount of the transaction price allocated to remaining performance obligations for: (1) contracts with an original expected duration of less than one year; or (2) those that qualify for the 'right to invoice' practical expedient. If a contract does not meet either of these criteria, an entity will be required to make the backlog disclosures. However, under these requirements, an entity is able to qualitatively describe any consideration that is not included in the transaction price (e.g., any estimated amount of variable consideration that is constrained).

5.4 Partial satisfaction of performance obligations prior to identifying the contract

An entity cannot begin to recognise revenue on an arrangement until it meets all five criteria to be considered a contract under the standards, regardless of whether it has received any consideration or has begun performing under the terms of the arrangement. Entities sometimes commence certain activities, such as administrative tasks or set-up activities, in anticipation of entering into a contract. Under the standards, an entity can capitalise certain fulfilment costs on specifically identified anticipated contracts, if specified criteria are met.

Entities will sometimes begin activities on a specifically anticipated contract either: (1) before agreeing to the contract with the customer; or (2) before the contract satisfies the criteria to be accounted for under the standards (referred to in the staff paper as the 'contract establishment date' or CED). If these activities will result in the transfer of a good or service to the customer at the CED, how should revenue for those activities be recognised at the CED? [TRG meeting 30 March 2015 - Staff paper no. 33]

TRG members generally agreed that if the goods or services that ultimately will be transferred meet the criteria to be recognised over time, revenue would be recognised on a cumulative catch-up basis at the CED, reflecting the performance obligation(s) that are partially or fully satisfied at that time. The cumulative catch-up method was deemed to be consistent with the overall principle of the standards that revenue is recognised when (or as) an entity transfers control of goods or services to a customer.

How should an entity account for fulfilment costs incurred prior to the CED that are outside the scope of another standard (e.g., IAS 2 Inventories/ASC 330, Inventory)? [TRG meeting 30 March 2015 - Staff paper no. 33]

TRG members generally agreed that costs in respect of pre-CED activities that relate to a good or service that will transfer to the customer at, or after, the CED may be capitalised as costs to fulfil a specifically anticipated contract. However, TRG members noted that such costs would still need to meet the other criteria in the standards to be capitalised (e.g., they are expected to be recovered under the anticipated contract). Subsequent to capitalisation, costs that relate to goods or services that are transferred to the customer at the CED would be expensed immediately. Any remaining capitalised costs would be amortised over the period that the related goods or services are transferred to the customer.

6. Other measurement and recognition topics

6.1 Warranties

The standards identify two types of warranties – service-type warranties and assurance-type warranties. A service-type warranty is where the customer has the option to purchase it separately or if it provides a service to the customer beyond fixing defects that existed at the time of sale; it is accounted for as a performance obligation. An assurance-type warranty does not provide an additional good or service, but, instead, is a promise to the customer that the delivered product is as specified in the contract; it is accounted for under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*/ASC 460, *Guarantees*.

How does an entity evaluate whether a product warranty is a service-type warranty (i.e., a performance obligation) when it is not separately priced? [TRG meeting 30 March 2015 – Staff paper no. 29]

TRG members generally agreed that the evaluation of whether a warranty provides a service in addition to the assurance that the product complies with agreed specifications will require judgement and depend on the facts and circumstances. There is no bright line in the standards on what constitutes a service-type warranty, beyond it being separately priced.

However, the standards do include three factors that would need to be considered in each evaluation (i.e., whether the warranty is required by law, the length of the warranty coverage and the nature of the tasks that the entity promises to perform). Entities will need to evaluate each type of warranty offered to determine the appropriate accounting treatment.

6.2 Pre-production activities

Some stakeholders have raised questions about how to account for pre-production activities. For example, some long-term supply arrangements require an entity to perform upfront engineering and design services to create new, or adapt existing, technology to the needs of a customer. The pre-production activity is often a pre-requisite to delivering any units under a production contract.

In Step 2 of the new model, an entity must identify the promised goods or services within a customer contract and determine which of those goods or services are performance obligations. However, the new standards specify that performance obligations do not include activities that an entity must undertake to fulfil a contract unless those activities transfer a good or service to the customer.⁹ In addition, IFRS 15 and ASC 340-40, *Other Assets and Deferred Costs – Contracts with Customers*, contain requirements on the accounting treatment for costs an entity incurs to obtain and fulfil a contract.

How should an entity assess whether pre-production activities are a promised good or service? [TRG meeting 9 November 2015 – Staff paper no. 46]

TRG members generally agreed that the determination of whether pre-production activities are a promised good or service or fulfilment activities will require judgement and consideration of the facts and circumstances.

⁹ IFRS 15.25.

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

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

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

How should an entity account for pre-production costs that currently are accounted under ASC 340-10, Other Assets and Deferred Costs? [TRG meeting 9 November 2015 - Staff paper no. 46] (This topic was raised only in a US GAAP context)

The FASB's new revenue standard did not amend the requirements in ASC 340-10 on pre-production costs related to long-term supply arrangements. TRG members meeting in Norwalk, Connecticut, generally agreed that an entity reporting under US GAAP that is appropriately following the requirements in ASC 340-10 today would continue to do so after implementation of the FASB's new revenue standard. However, several TRG members queried whether the requirements in ASC 340-10 should be deleted because they appear unnecessary and potentially inconsistent with the revenue and cost requirements in ASC 606 and ASC 340-40, respectively. TRG members meeting in London did not discuss this issue because the question was only raised in relation to existing US GAAP.

Will pre-production costs for contracts that were previously within the scope of ASC 605-35, Revenue Recognition - Construction-Type and Production-Type Contracts, be within the scope of the cost guidance in ASC 340-10 or ASC 340-40? [TRG meeting 9 November 2015 - Staff paper no. 46] (This topic was raised only in a US GAAP context)

The contract cost requirements in ASC 605-35 will be superseded by the FASB's new revenue standard. TRG members meeting in Norwalk generally agreed that an entity reporting under US GAAP that is appropriately accounting for contract costs under ASC 605-35 today, would account for those contract costs under ASC 340-40 after adopting the FASB's new revenue standard. TRG members meeting in London did not discuss this issue because the question was only raised in relation to existing US GAAP.

6.3 Incremental costs to obtain a contract

Under IFRS 15/ASC 340-40, the incremental cost of obtaining a contract (e.g., sales commissions) will be recognised as an asset if the entity expects to recover it.

The following questions were discussed at the 26 January 2015 TRG meeting - Staff paper no. 23:

When, and for how much, would an entity capitalise commissions that are paid on renewal contracts? How would an entity amortise such an asset and evaluate whether the renewals are commensurate with the initial commissions paid?

Should commissions earned on contract modifications that are not treated as separate contracts be capitalised?

If commissions are contingent on future events, can they be considered incremental?

Can commissions that are subject to clawbacks and/or achieving cumulative thresholds be capitalised?

Should fringe benefits on commission payments be included in the capitalised amounts?

What is the pattern of amortisation for a contract cost asset that relates to multiple performance obligations that are satisfied over disparate periods of time?

Instead of focusing on the detailed questions in the staff paper, TRG members discussed the underlying principle for capitalising costs under the standards. TRG members generally agreed that IFRS 15 (ASC 340-40 or ASC 606) did not amend the current IFRS/US GAAP liabilities standards. Therefore, entities would first refer to the applicable liabilities standards to determine when they are required to accrue for certain costs. Entities would then use the requirements in IFRS 15/ASC 340-40 to determine whether the related costs need to be capitalised.

TRG members generally agreed that certain aspects of the recognition of costs will require entities to apply significant judgement in analysing the facts and circumstances and determining the appropriate accounting treatment. For example, judgement will be needed to assess items such as the amortisation pattern for a contract cost asset that relates to multiple performance obligations that are satisfied over different periods of time.

6.4 Impairment testing of capitalised contract costs

Any costs capitalised under IFRS 15/ASC 340-40 (i.e., costs incurred in fulfilling a contract and incremental costs of obtaining a contract) are subject to an impairment assessment at the end of each reporting period. An impairment exists if the carrying amount of any asset(s) exceeds the amount of consideration the entity expects to receive in exchange for providing the related promised goods and services, less the remaining costs that directly relate to providing those goods and services.

Should entities include contract renewals or extensions when determining the remaining amount of consideration they expect to receive in order to perform an impairment test on capitalised contract costs? [TRG meeting 18 July 2014 - Staff paper no. 4]

TRG members generally agreed that an impairment test of capitalised contract costs should include future cash flows associated with contract renewal or extension periods. The question was raised because of an inconsistency within IFRS 15 and between ASC 340-40 and ASC 606. IFRS 15/ASC 340-40 indicates that costs capitalised under the standards could relate to goods or services to be transferred under 'a specific anticipated contract' (e.g., goods or services to be provided under contract renewals and/or extensions). The requirements further indicate that an impairment loss would be recognised when the carrying amount of the asset exceeds the remaining amount of consideration expected to be received in exchange for the goods or services to which the asset relates and that an entity would use the principles of IFRS 15/ASC 606 when determining the remaining transaction price. However, IFRS 15.49/ASC 606-10-32-4 indicates that an entity should not anticipate that the contract will be 'cancelled, renewed or modified' when determining the transaction price.

In some instances, excluding renewals or extensions would trigger an immediate impairment of a contract asset because the consideration an entity expects to receive would not include anticipated cash flows from contract extensions or renewal periods, but the entity would have capitalised contract costs on the basis that they would be recovered over the contract extension or renewal periods.

6.5 Contract assets and liabilities

The standards are based on the notion that a contract asset or contract liability is generated when either party to a contract performs. The standards require that an entity present these contract assets or contract liabilities in the statement of financial position. When an entity satisfies a performance obligation by delivering the promised good or service, it has earned a right to consideration from the customer and, therefore, has a contract asset. When the customer performs first, for example, by prepaying its promised consideration, the entity has a contract liability.

How would an entity determine the presentation of contract assets and liabilities for contracts that contain multiple performance obligations? [TRG meeting 31 October 2014 - Staff paper no. 7]

TRG members generally agreed that contract assets and liabilities would be determined at the contract level and not at the performance obligation level (i.e., an entity would not separately recognise an asset or liability for each performance obligation within a contract, but would aggregate them into a single contract asset or liability).

Contract assets and liabilities would be aggregated at the contract level and not at the performance obligation level.

How would an entity determine the presentation of two or more contracts that are required to be combined under the standards? [TRG meeting 31 October 2014 - Staff paper no. 7]

TRG members generally agreed that the contract asset or liability would be combined (i.e., presented net) for different contracts with the same customer (or a related party of the customer) if an entity is otherwise required to combine those contracts under the standards. However, TRG members acknowledged that this analysis may be operationally difficult for some entities because their systems will generally capture data at the performance obligation level in order to comply with the recognition and measurement requirements of the standards.

When would an entity offset contract assets and liabilities against other balance sheet items (e.g., accounts receivable)? [TRG meeting 31 October 2014 - Staff paper no. 7]

TRG members generally agreed that, because the standards do not provide requirements for offsetting, entities will need to apply the requirements of other standards (e.g., IAS 32 *Financial Instruments: Presentation*/ASC 210-20, *Balance Sheet – Offsetting*) to determine whether offsetting is appropriate.

7. Scope of the standards

7.1 Islamic financing transactions (this topic was raised in an IFRS context)

Islamic financial institutions (IFIs) enter into Sharia-compliant instruments and transactions that do not result in IFIs earning interest on loans. Instead, these transactions involve purchases and sales of real assets (e.g., vehicles) on which IFIs can earn a premium to compensate them for deferred payment terms. Typically, an IFI makes a cash purchase of the underlying asset, takes legal possession, even if only for a short time, and immediately sells it on deferred payment terms. The financial instruments created by these transactions are within the scope of the financial instruments standards.¹⁰

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

TRG members meeting in London generally agreed that Sharia-compliant instruments and transactions may be outside the scope of the revenue standards. However, the analysis would depend on the specific facts and circumstances, and may require significant judgement as contracts often differ within and between jurisdictions. TRG members meeting in Norwalk did not discuss this issue.

7.2 Determining the scope for certain credit card arrangements

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

Are credit card fees in the scope of the FASB's new revenue standard? [TRG meeting 13 July 2015 - Staff paper no. 36]

TRG members in Norwalk generally agreed that credit card fees that are accounted for under ASC 310, *Receivables*, are not in the scope of ASC 606. This includes annual fees that may entitle cardholders to ancillary services. TRG members in Norwalk noted that this conclusion is consistent with today's accounting for credit card fees. However, the SEC Observer noted, and TRG members in Norwalk generally agreed, that the nature of the arrangement must be truly that of a credit card lending arrangement in order to be in the scope of ASC 310, and entities will need to continue to evaluate their arrangements as new programmes develop.

While this question has only been raised by US GAAP stakeholders, TRG members in London generally agreed that an IFRS preparer would first need to determine whether the credit card fees are within the scope of IFRS 9 or IAS 39.

¹⁰ IFRS 9 (or IAS 39) and IAS 32.

IFRS 9/IAS 39 requires that any fees that are an integral part of the effective interest rate for a financial instrument be treated as an adjustment to the effective interest rate. Conversely, any fees that are not an integral part of the effective interest rate of the financial instrument will generally be accounted for under IFRS 15. Therefore, credit card fees could be treated differently under IFRS and US GAAP.

Are cardholder rewards programmes in the scope of the FASB's new revenue standard? [TRG meeting 13 July 2015 - Staff paper no. 36] (This topic was only raised in a US GAAP context)

TRG members in Norwalk generally agreed if all consideration (i.e., credit card fees) related to the rewards programme are determined to be in the scope of ASC 310, the rewards programme would not be in the scope of ASC 606. However, this determination would have to be made based on facts and circumstances, due to the wide variety of credit card reward programmes offered. TRG members meeting in London did not discuss this issue because the question was only raised in relation to existing US GAAP.

7.3 Contributions (this topic was raised in a US GAAP context)

Today, not-for-profit entities that report under US GAAP follow ASC 958-605, *Not-for-Profit Entities – Revenue Recognition*, to account for contributions (i.e., unconditional promises of cash or other assets in voluntary non-reciprocal transfers). Contributions are not explicitly excluded from the scope of the FASB's new revenue standard. However, ASC 958-605 will not be wholly superseded by the FASB's new revenue standard (i.e., ASC 606).

Are contributions in the scope of the FASB's new revenue standard? [TRG meeting 30 March 2015 - Staff paper no. 26]

TRG members meeting in Norwalk generally agreed that contributions are not within the scope of ASC 606 because they are non-reciprocal transfers. That is, contributions are generally not given in exchange for goods or services that are an output of the entity's ordinary activities. TRG members meeting in London did not discuss this issue because the question was only raised in relation to existing US GAAP.

7.4 Gambling entities - fixed-odds wagering contracts (this topic was raised in a US GAAP context)

Under IFRS, consistent with a July 2007 IFRS Interpretations Committee agenda decision, wagers that meet the definition of a derivative are within the scope of IFRS 9 or IAS 39. Those that do not meet the definition of a derivative would be within the scope of IFRS 15.

Today, US GAAP gambling entities account for earnings from fixed-odds wagering contracts as gambling revenue under ASC 924-605, *Entertainment – Casinos – Revenue Recognition*. These industry-specific requirements will be superseded by ASC 606. In fixed-odds wagering contracts, the pay-out for wagers placed on gambling activities (e.g., table games, slot machines, sports betting) is known at the time when the wager is placed. US GAAP stakeholders have questioned whether these contracts are within the scope of the FASB's new revenue standard or whether they could meet the definition of a derivative and be in the scope of ASC 815, *Derivatives and Hedging*.

Are fixed-odds wagering contracts within the scope of the FASB's new revenue standard? [TRG meeting 9 November 2015 - Staff paper no. 47]

TRG members meeting in Norwalk generally agreed that it was not clear whether fixed-odds wagering contracts should be in the scope of the FASB's new revenue standard or ASC 815. ASC 606 scopes in all contracts with customers unless the contracts are within the scope of other requirements, such as ASC 815. TRG members agreed that it was possible that fixed-odds wagering contracts would meet the definition of a derivative under ASC 815 and, therefore, be scoped out of ASC 606. If the FASB believes that these contracts should be considered as revenue arrangements and should be accounted for under ASC 606, once the industry-specific standard is superseded, TRG members meeting in Norwalk recommended that a clarification be codified within US GAAP. TRG members meeting in London did not discuss this issue because the question was only raised in relation to existing US GAAP.

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