Applying IFRS

A closer look at the new revenue recognition standard

Updated October 2015
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What you need to know

- IFRS 15 creates a single source of revenue requirements for all entities in all industries. The new revenue standard is a significant change from current IFRS.

- The new standard applies to revenue from contracts with customers and replaces all of the revenue standards and interpretations in IFRS, including IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfers of Assets from Customers and SIC-31 Revenue - Barter Transaction involving Advertising Services.

- IFRS 15 is principles-based, consistent with current revenue requirements, but provides more application guidance. The lack of bright lines will result in the need for increased judgement.

- The new standard will have little effect on some entities, but will require significant changes for others, especially those entities for which current IFRS provides little application guidance.

- IFRS 15 also specifies the accounting treatment for certain items not typically thought of as revenue, such as certain costs associated with obtaining and fulfilling a contract and the sale of certain non-financial assets.
Overview

In May 2014, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) (collectively, the Boards) respectively issued converged new revenue standards: IFRS 15 Revenue from Contracts with Customers and Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (largely codified in Accounting Standards Codification (ASC) 606) (together with IFRS 15, the new revenue standards). These new revenue standards will supersede virtually all revenue recognition requirements in IFRS and US GAAP, respectively.

Noting several concerns with existing requirements for revenue recognition under both US GAAP and IFRS, the Boards decided to jointly develop new revenue standards that would:

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

IFRS 15 specifies the accounting treatment for all revenue arising from contracts with customers. It applies to all entities that enter into contracts to provide goods or services to their customers, unless the contracts are in the scope of other IFRSs, such as IAS 17 Leases. The standard also provides a model for the measurement and recognition of gains and losses on the sale of certain non-financial assets, such as property, plant or equipment.

As a result, IFRS 15 will likely affect an entity’s financial statements, business processes and internal controls over financial reporting. While some entities will be able to implement the standard with limited effort, others may find implementation a significant undertaking. Successful implementation will require an assessment of and a plan for managing the change.

The standards under IFRS and US GAAP were identical when issued except for the following:

- The Boards use the term ‘probable’ to describe the level of confidence needed when assessing collectability to identify contracts with customers, which has a lower threshold under IFRS than US GAAP (as discussed in Section 3.1.5)
- The FASB requires more disclosures in interim financial statements than the IASB
- The IASB allows early adoption
- The IASB permits reversals of impairment losses and the FASB does not
- The FASB provides relief for non-public entities (i.e., an entity that does not meet the definition of a public entity in the US GAAP version of the standard) relating to specific disclosure requirements, the effective date and transition

1 IFRS 15.IN5
The standard outlines the principles an entity must apply to measure and recognise revenue and the related cash flows. The core principle is that an entity will recognise revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to a customer.

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

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

An entity will need to exercise judgement when considering the terms of the contract(s) and all of the facts and circumstances, including implied contract terms. An entity will also have to apply the requirements of the standard consistently to contracts with similar characteristics and in similar circumstances. To assist entities, IFRS 15 includes detailed application guidance and illustrative examples. We include a list of these examples in Appendix B to this publication.

IFRS 15 must be adopted using either a fully retrospective approach for all periods presented in the period of adoption (with some limited relief provided) or a modified retrospective approach. When it was issued, the standard was mandatorily effective for annual periods beginning on or after 1 January 2017 for IFRS preparers. US GAAP public entity preparers were required to adopt the standard for annual periods beginning after 15 December 2016. However, in July 2015, both Boards decided to defer the effective date of their new revenue standards by one year (see Section 1.1 below for further discussion).

Following issuance of the standards, 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 standards. TRG members include financial statement preparers, auditors and users from a variety of industries, countries and public and private entities. While any views expressed by members of the TRG are non-authoritative, they represent the latest thinking on each topic and entities should consider them as they implement the new revenue standards.

This publication highlights key aspects of IFRS 15, including the issues discussed by the TRG. On 30 July 2015, the IASB issued an exposure draft, Exposure Draft ED/2015/6, *Clarifications to IFRS 15 (ED)*, proposing several amendments to IFRS 15, many of which address issues the TRG has previously discussed, but on which the TRG members were unable to reach general agreement. Comments are due to the IASB on this exposure draft by 28 October 2015. Throughout this publication, we highlight the proposed amendments, including where illustrative examples may change, and compare them with those proposed by the FASB in three exposure drafts (issued in May, July and September 2015). The FASB began redeliberations in October 2015 on its May exposure draft on identifying performance obligations and licences of intellectual property. Comments are due on its other exposure drafts on principal versus agent considerations by 15 October 2015 and on transition,

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2 The Exposure Draft can be found at www.ifrs.org.
collectability, non-cash consideration and the presentation of sales taxes by 16 November 2015, respectively. We have also issued industry-specific publications\(^3\) that address significant changes to current industry practice. We encourage preparers and users of financial statements to read this publication and the industry supplements carefully and consider the potential effects of the standard.

The views we express in this publication are preliminary. We may identify additional issues during implementation and our views may evolve during that process. The conclusions we describe in our illustrations are also subject to change as views evolve. Conclusions in seemingly similar situations may differ from those reached in the illustrations due to differences in the underlying facts and circumstances.

\(^3\) See www.ey.com/IFRS
1. Effective date and transition

1.1 Effective date

When it was issued, IFRS 15 was effective for annual periods beginning on or after 1 January 2017. Early adoption was permitted for IFRS preparers provided that fact is disclosed, and for first-time adopters of IFRS. However, in September 2015, the IASB issued an amendment to IFRS 15 to defer the effective date by one year. As a result, IFRS 15 is now effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted.4

As a result of a one-year deferral by the FASB5, its new revenue standard is effective for public entities applying US GAAP for fiscal years beginning after 15 December 2017, which is essentially the same as for IFRS preparers.6 Adoption is permitted as early as the original public entity effective date (i.e., annual reporting periods beginning after 15 December 2016 and interim periods therein). Early adoption under US GAAP prior to that date is not permitted.

The table below illustrates the effective date of IFRS 15, including the effect of the one-year deferral, for entities with differing year-ends and assumes that entities report results twice a year (annual and half-year).

<table>
<thead>
<tr>
<th>Year-end</th>
<th>Mandatory adoption</th>
<th>Early adoption</th>
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<tbody>
<tr>
<td>31 December</td>
<td>1 January 2018 adoption date. Present for the first time in 30 June 2018 interim financial statements or 31 December 2018 annual financial statements.</td>
<td>Possible adoption dates include, but are not limited to:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 1 January 2014 adoption date. Present for the first time in 30 June 2014 interim financial statements or 31 December 2014 annual financial statements.</td>
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<tr>
<td></td>
<td></td>
<td>• 1 January 2015 adoption date. Present for the first time in 30 June 2015 interim financial statements or 31 December 2015 annual financial statements.</td>
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<tr>
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<td></td>
<td>• 1 January 2016 adoption date. Present for the first time in 30 June 2016 interim financial statements or 31 December 2016 annual financial statements.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 1 January 2017 adoption date. Present for the first time in 30 June 2017 interim financial statements or 31 December 2017 annual financial statements.</td>
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</table>

4 Effective Date of IFRS 15, issued by the IASB in September 2015

5 FASB ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date

6 US non-public entities will be required to apply ASC 606 to annual reporting periods beginning after 15 December 2018 and interim periods within annual reporting periods beginning after 15 December 2019. Adoption is permitted as early as the original public entity effective date. Early adoption prior to that date is not permitted.
1.2 Transition approaches

IFRS 15 requires retrospective application. The Boards decided to allow either ‘full retrospective’ adoption in which the standards are applied to all of the periods presented or a ‘modified retrospective’ adoption. See Sections 1.2.1 and 1.2.2 below, respectively.

IFRS 15 defines the following terms:⁷

- The date of initial application - the start of the reporting period in which an entity first applies IFRS 15. For example, for an entity whose annual reporting period ends on 30 June, the mandatory date of initial application will be 1 July 2018.

- Completed contract - a contract in which the entity has fully transferred all of the identified goods and services before the date of initial application. As a result, entities do not need to apply IFRS 15 to contracts if they have completed performance before the date of initial application, even if they have not yet received the consideration and that consideration is still subject to variability.

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⁷ IFRS 15.C2
Summary of recent TRG discussions
At the July 2015 TRG meeting, members of the TRG observed that it may sometimes be difficult to determine when a contract should be considered ‘complete’ for purposes of applying the transition requirements and how these completed contracts would be accounted for after entities adopt the new standards. In September 2015, the FASB proposed an amendment to ASC 606 to clarify that a completed contract is one for which all (or substantially all) of the revenue was recognised under previous US GAAP revenue requirements. The IASB discussed this issue at its September 2015 meeting and decided not to propose any amendments to IFRS 15.

The IASB agreed that the definition of a completed contract includes a contract in which the goods or services have been transferred to a customer, but for which revenue has not been fully recognised due to collectability issues or uncertainties in measurement. In addition, an entity would not apply IFRS 15 in the subsequent periods to account for such a completed contract. Instead, the entity would account for the completed contract under existing IFRSs (i.e., IAS 11, IAS 18 and related Interpretations).

In July 2015, the IASB proposed adding two practical expedients to IFRS 15 to alleviate the transition burden of accounting for completed contracts and contracts that were modified prior to adoption under both transition approaches (i.e., full and modified retrospective). Without the practical expedients, the assessment of contracts could be onerous for entities that have completed contracts for which revenue has not been fully recognised or multi-year contracts that have been modified many times prior to adoption of IFRS 15. The two proposed practical expedients would allow:

- An entity that uses the full retrospective approach to only apply IFRS 15 to contracts that are not completed, as defined, as at the beginning of the earliest period presented. IFRS 15 already allows a similar accounting treatment for entities that choose to use the modified retrospective approach (see Section 1.2.2 below).

- An entity, under either transition approach, to determine the aggregate effect of all of the modifications that occurred between contract inception and the earliest date presented in the financial statements, rather than accounting for the effects of each modification separately. An entity would be permitted to use hindsight to identify the satisfied and unsatisfied performance obligations and to determine the transaction price to allocate to those performance obligations.

The exposure draft also proposes that, if an entity were to apply these practical expedients, it would be required to apply them to all contracts with similar characteristics.\(^8\)

In September 2015, the FASB proposed adding a similar practical expedient as that proposed by the IASB on contract modifications. The FASB’s proposed practical expedient would mean that an entity would not be required to evaluate the individual effects of each contract modification from contract inception through to the beginning of the earliest period presented under ASC 606 using either transition approach. In addition, the FASB proposed a technical correction to clarify that an entity that uses the full retrospective approach does not need to disclose the effect of the accounting change on affected financial statement line items in the period of adoption.

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\(^8\) Exposure draft ED/2015/6, Clarifications to IFRS 15, paragraphs C5-C7A
1.2.1 Full retrospective adoption

Entities electing the full retrospective adoption will apply the provisions of IFRS 15 to each period presented in the financial statements, in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, subject to the practical expedients created to provide relief, as discussed below.

<table>
<thead>
<tr>
<th>Extract from IAS 8</th>
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<tr>
<td><strong>Applying changes in accounting policies</strong></td>
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<td>19. Subject to paragraph 23:</td>
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<tr>
<td>(a) an entity shall account for a change in accounting policy resulting from the initial application of an IFRS in accordance with the specific transitional provisions, if any, in that IFRS; and</td>
</tr>
<tr>
<td>(b) when an entity changes an accounting policy upon initial application of an IFRS that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.</td>
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<tr>
<td>20. For the purpose of this Standard, early application of an IFRS is not a voluntary change in accounting policy.</td>
</tr>
<tr>
<td>21. In the absence of an IFRS that specifically applies to a transaction, other event or condition, management may, in accordance with paragraph 12, apply an accounting policy from the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards. If, following an amendment of such a pronouncement, the entity chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy.</td>
</tr>
<tr>
<td><strong>Retrospective application</strong></td>
</tr>
<tr>
<td>22. Subject to paragraph 23, when a change in accounting policy is applied retrospectively in accordance with paragraph 19(a) or (b), the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.</td>
</tr>
<tr>
<td><strong>Limitations on retrospective application</strong></td>
</tr>
<tr>
<td>23. When retrospective application is required by paragraph 19(a) or (b), a change in accounting policy shall be applied retrospectively except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change.</td>
</tr>
</tbody>
</table>
24. When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.

25. When it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable.

26. When an entity applies a new accounting policy retrospectively, it applies the new accounting policy to comparative information for prior periods as far back as is practicable. Retrospective application to a prior period is not practicable unless it is practicable to determine the cumulative effect on the amounts in both the opening and closing statements of financial position for that period. The amount of the resulting adjustment relating to periods before those presented in the financial statements is made to the opening balance of each affected component of equity of the earliest prior period presented. Usually the adjustment is made to retained earnings. However, the adjustment may be made to another component of equity (for example, to comply with an IFRS). Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable.

27. When it is impracticable for an entity to apply a new accounting policy retrospectively, because it cannot determine the cumulative effect of applying the policy to all prior periods, the entity, in accordance with paragraph 25, applies the new policy prospectively from the start of the earliest period practicable. It therefore disregards the portion of the cumulative adjustment to assets, liabilities and equity arising before that date. Changing an accounting policy is permitted even if it is impracticable to apply the policy prospectively for any prior period. Paragraphs 50–53 provide guidance on when it is impracticable to apply a new accounting policy to one or more prior periods.

Under the full retrospective approach, entities will have to apply IFRS 15 as if it had been applied since the inception of all its contracts with customers that are presented in the financial statements. During deliberations, the Boards seemed to prefer the full retrospective approach, under which all contracts with customers are recognised and measured consistently in all periods presented within the financial statements, regardless of when the contracts were entered into. This approach also provides users of the financial statements with useful trend information across all periods presented.
However, to ease the potential burden of applying it on a fully retrospective basis, the Boards provided the following relief:

**Extract from IFRS 15**

C3. An entity shall apply this Standard using one of the following two methods:

(a) retrospectively to each prior reporting period presented in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, subject to the expedients in paragraph C5; or

(b) retrospectively with the cumulative effect of initially applying this Standard recognised at the date of initial application in accordance with paragraphs C7–C8.

C5. An entity may use one or more of the following practical expedients when applying this Standard retrospectively in accordance with paragraph C3(a):

(a) for completed contracts, an entity need not restate contracts that begin and end within the same annual reporting period;

(b) for completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods; and

(c) for all reporting periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue (see paragraph 120).

C6. For any of the practical expedients in paragraph C5 that an entity uses, the entity shall apply that expedient consistently to all contracts within all reporting periods presented. In addition, the entity shall disclose all of the following information:

(a) the expedients that have been used; and

(b) to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.

Entities may elect to apply none, some or all of these expedients. However, if an entity elects to use any of them, it must apply that expedient consistently to all contracts within all periods presented. It would not be appropriate to apply the selected expedient to some, but not all, of the periods presented. Entities that choose to use some, or all, of the relief will be required to provide additional qualitative disclosures (i.e., the types of relief the entity has applied and the likely effect of that application).

In July 2015, the IASB proposed two additional practical expedients for entities that apply a full retrospective approach. These proposed practical expedients are discussed further in Section 1.2.
An entity that elects to apply the standard retrospectively must also provide the disclosures required in IAS 8, as follows:

**Extract from IAS 8**

**Disclosure**

28. When initial application of an IFRS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the title of the IFRS;
(b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;
(c) the nature of the change in accounting policy;
(d) when applicable, a description of the transitional provisions;
(e) when applicable, the transitional provisions that might have an effect on future periods;
(f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment.
   (i) for each financial statement line item affected; and
   (ii) if IAS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share;
(g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and
(h) if retrospective application required by paragraph 19(a) or (b) is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

The IASB provided some additional relief from disclosures for an entity that elects to apply IFRS 15 on a fully retrospective basis. Although permitted to do so, an entity need not present the quantitative information required by IAS 8.28(f) for periods other than the annual period immediately preceding the first annual period for which IFRS 15 is applied (the 'immediately preceding period').

**1.2.2 Modified retrospective adoption**

Entities that elect the modified retrospective approach will apply the standard retrospectively to only the most current period presented in the financial statements (i.e., the initial period of application). To do so, the entity will have to recognise the cumulative effect of initially applying IFRS 15 as an adjustment to the opening balance of retained earnings (or other appropriate components of equity) at the date of initial application.
Under this approach, IFRS 15 will be applied to contracts that are not yet completed at the date of initial application (e.g., 1 January 2018 for an entity with a 31 December year-end following the IASB’s amendment to defer the effective date by one year, see Section 1.1 above). That is, contracts that are not completed before the date of initial application will have to be evaluated as if the entity had always applied IFRS 15 to these contracts. Under this approach, an entity will:

- Present comparative periods in accordance with IAS 11, IAS 18 and related Interpretations
- Apply IFRS 15 to new and existing contracts from the effective date onwards
- Recognise a cumulative catch-up adjustment to the opening balance of retained earnings at the effective date for existing contracts that still require performance by the entity in the year of adoption, disclose the amount by which each financial statement line item was affected as a result of applying IFRS 15 and an explanation of significant changes

In the exposure draft issued by the IASB in July 2015⁹, the Board proposed an additional practical expedient for contract modifications for entities that apply a modified retrospective approach. This proposed practical expedient is discussed further in Section 1.2.

How we see it

Depending on an entity’s prior accounting policies, applying the modified retrospective approach may be more difficult than an entity would anticipate. Situations that may make application under this approach more complex include the following:

- The performance obligations identified under IFRS 15 are different from the elements/deliverables identified under today’s requirements.
- The relative stand-alone selling price allocation required by IFRS 15 results in different amounts of the consideration being allocated to performance obligations than had been allocated in the past.
- The contract contains variable consideration and the amount of variable consideration that can be included in the allocable consideration differs from the amount under today’s requirements.

In addition, the modified retrospective approach effectively requires an entity to keep two sets of books in the year of adoption in order to comply with the requirement to disclose all line items in the financial statements as if they were prepared under today’s requirements.

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⁹ Exposure draft ED/2015/6, Clarifications to IFRS 15
The following example illustrates the potential effects of the modified retrospective approach:

**Illustration 1-1 – Cumulative effect of adoption under the modified retrospective approach**

A software vendor with a 31 December year-end adopts IFRS 15 on 1 January 2018. The vendor adopts the standard using the modified retrospective approach.

The vendor frequently enters into contracts to provide a software licence, professional services and post-delivery service support. It previously accounted for its contracts in accordance with IAS 18, in consideration of IAS 18.IE19. As a result, it recognised fees from the development of its software by reference to the stage of completion of the development, which included the completion of post-delivery service support services. In effect, the software vendor treated the development of software and post-delivery service support as a single deliverable.

Under IFRS 15, the vendor may reach a different conclusion regarding the number of deliverables than it did under IAS 18, because IFRS 15 provides more detailed requirements for determining whether promised goods and services are performance obligations (discussed further in Section 4.2).

As a result, the vendor’s analysis of contracts in progress as of 1 January 2018 may result in the identification of different performance obligations from those it previously used for revenue recognition. As part of this assessment, the entity would need to allocate the estimated transaction price, based on the relative stand-alone selling price method (see Section 6.2), to the newly identified performance obligations.

The vendor would compare the revenue recognised for each contract, from contract inception through to 31 December 2017, to the amount that would have been recognised if the entity had applied IFRS 15 since contract inception. The difference between those two amounts would be accounted for as a cumulative catch-up adjustment and recognised as at 1 January 2018 in opening retained earnings. From 1 January 2018 onwards, revenue recognised would be based on IFRS 15.

### 1.3 Application considerations

Regardless of the transition approach they choose, many entities will have to apply the standard to contracts entered into in prior periods. The population of contracts will be larger under the full retrospective approach. However, under the modified retrospective approach, entities will have to apply IFRS 15 to all contracts that are in progress as of the date of initial application, regardless of when those contracts commenced.

While the Boards provided some relief from a full retrospective approach and provided the option of a modified retrospective approach, a number of application issues still exist that may make applying IFRS 15 difficult and/or time-consuming, for example:

- In the case of full retrospective adoption, entities will likely be required to perform an allocation of the transaction price because of changes to the identified deliverables, the transaction price or both. If an entity previously performed a relative fair value allocation, this step may be straightforward. Regardless, an entity will be required to determine the stand-alone selling price of each performance obligation as at inception of the contract.
Depending on the age of the contract, this information may not be readily available and the prices may differ significantly from current stand-alone selling prices. While the standard is clear as to when it is acceptable to use hindsight in respect of variable consideration to determine the transaction price (see Section 5.1 for a discussion on variable consideration), it is silent on whether the use of hindsight is acceptable for other aspects of the model (e.g., for the purpose of allocating the transaction price) or whether it would be acceptable to use current pricing information if that were the only information available.

Estimating variable consideration for all contracts for prior periods will likely require significant judgement. The standard is clear that hindsight cannot be used for contracts in progress when applying the full retrospective method. Notwithstanding the proposed amendments to IFRS 15 on accounting for contract modifications under the modified retrospective approach (see Section 1.2), the standard is silent on whether the use of hindsight is acceptable for entities applying the modified retrospective approach. However, the Boards’ discussion in the Basis for Conclusions implies that there are no practical expedients for the modified retrospective approach. Furthermore, since entities applying the modified retrospective approach will only be adjusting contracts in-progress, it seems likely that the use of hindsight is not acceptable. As a result, entities must make this estimate based only on information that was available at contract inception. Contemporaneous documentation clarifying what information was available to management, and when it was available, will likely be needed to support these estimates. In addition to estimating variable consideration using the expected value or a most likely amount approach, entities will have to make conclusions about whether such variable consideration is subject to the constraint (see Section 5.1 for further discussion).

The modified retrospective approach does not require entities to restate the amounts reported in prior periods. However, at the date of initial application, entities electing this approach will still have to calculate the revenues they would have recognised for any open contracts as if they had always applied IFRS 15. This is needed in order to determine the cumulative effect of adopting the new standard. It is likely to be most challenging for contracts in which the identified elements/deliverables or allocable consideration change when the new requirements are applied.

Finally, entities will need to consider a number of other issues as they prepare to adopt IFRS 15. For example, entities with significant deferred revenue balances under current IFRS may experience what some are referring to as ‘lost revenue’ if those amounts were deferred at the adoption date of IFRS 15 and will, ultimately, be reflected in the restated prior periods or as part of the cumulative adjustment upon adoption, but are never reported as revenue in a current period within the financial statements.

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10 See IFRS 15.BC439-BC443
In addition, when an entity has not applied a new standard that has been issued but is not yet effective, IAS 8 requires the entity to disclose that fact and known or reasonably estimable information relevant to assessing the possible impact that application of a standard will have on the financial statements in the period of initial application. In producing the above disclosure, an entity is required to consider disclosing all of the following:
>
- The title of the new standard
- The nature of the impending change or changes in accounting policy
- The date by which application of the standard is required
- The date as at which it plans to apply the standard initially
- A discussion of the impact that initial application of the standard is expected to have on the entity's financial statements or, if that impact is not known or reasonably estimable, a statement to that effect

**How we see it**

Some entities still may not know, or be able to make, a reasonable estimate of the impact IFRS 15 will have on their financial statements and will make a statement to that effect.

Regulators are likely to expect an entity's disclosures to evolve in each reporting period as more information about the effects of the new standard becomes available.

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11 IAS 8.30
12 IAS 8.31
2. Scope

The scope of the standard includes all contracts with customers to provide goods or services in the ordinary course of business, except for the following contracts, which are specifically excluded:

- Lease contracts within the scope of IAS 17 Leases
- Insurance contracts within the scope of IFRS 4 Insurance Contracts
- Financial instruments and other contractual rights or obligations within the scope of IFRS 9 Financial Instruments or IAS 39 Financial Instruments: Recognition and Measurement, IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IAS 27 Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures
- Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers

In addition, the contracts within the scope of the standard must meet the criteria set out in IFRS 15.9, which are discussed in Section 3.1 below.

For certain arrangements, entities will have to evaluate their relationship with the counterparty to the contract in order to determine whether a vendor-customer relationship exists. Some collaboration arrangements, for example, are more akin to a partnership, while others have a vendor-customer relationship. Only transactions that are determined to be with a customer are within the scope of IFRS 15. See Section 2.2 for a discussion on collaborative arrangements.

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

Entities may enter into transactions that are partially within the scope of IFRS 15 and partially within the scope of other standards. In these situations, the standard requires an entity to apply any separation and/or measurement requirements in the other standard first, before applying the requirements in IFRS 15. See Section 2.3 for further discussion.

2.1 Definition of a customer

The standard defines a customer "as a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration". In many transactions, a customer is easily identifiable. However, in transactions involving multiple parties, it may be less clear which counterparties are customers of the entity. For some arrangements, multiple parties could all be considered customers of the entity. However, for other arrangements, only some of the parties involved are considered customers. Illustration 2-1 below shows how a party considered to be the customer may differ, depending on the specific facts and circumstances. The identification of the performance obligations in a contract (discussed further in Section 4.1) can have a significant effect on the determination of which party is the entity’s customer.

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13 IFRS 15 Appendix A
IFRS 15 does not define the term ‘ordinary activities’ because it is already widely used in IFRS.

**Illustration 2-1 — Identification of a customer**

An entity provides internet-based advertising services to companies. As part of those services, the entity purchases banner-space on various websites from a selection of publishers. For certain contracts, the entity provides a sophisticated service of matching the ad placement with the pre-identified criteria of the advertising party (i.e., the customer). In addition, the entity pre-purchases the banner-space from the publishers before it finds advertisers for that space. Assume that the entity appropriately concludes it is acting as the principal in these contracts (see Section 4.4 for further discussion on this topic). Based on the nature of the goods and services being provided, the entity identifies that its customer is the advertiser and gross revenue will be recognised as the sophisticated advertising services are provided.

In other contracts, the entity simply matches advertisers with the publishers in its portfolio, but the entity does not provide any sophisticated ad-targeting services. Assume that the entity appropriately concludes it is acting as the agent in these contracts. Based on the nature of the goods and services being provided, the entity identifies that its customer is the publisher and net revenue will be recognised as those agency services are provided to the publisher.

### 2.2 Collaborative arrangements

In certain transactions, a counterparty may not always be a ‘customer’ of the entity. Instead, the counterparty may be a collaborator or partner that shares in the risks and benefits of developing a product to be marketed. This is common in the pharmaceutical, bio-technology, oil and gas, and health care industries. However, depending on the facts and circumstances, these arrangements may also contain a vendor-customer relationship component. Such contracts could still be within the scope of IFRS 15, at least partially, if the collaborator or partner meets the definition of a customer for some, or all, aspects of the arrangement.

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

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

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14 IFRS 15.BC54
How we see it

Under current IFRS, identifying the customer can be difficult, especially when multiple parties are involved in the transaction. This evaluation may require significant judgement and the new standard does not provide additional factors to consider.

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

2.3 Interaction with other standards

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

**Extract from IFRS 15**

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

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

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

Only after applying other applicable standards will an entity apply IFRS 15 to the remaining components of an arrangement. Some examples of where separation and/or allocation are addressed in other IFRS include the following:

- **IAS 39** requires that a financial instrument be recognised at fair value at initial recognition. For contracts that include the issuance of a financial instrument and revenue components, the fair value of the financial instrument is first measured and the remainder of the estimated contract consideration is allocated among the other components in the contract in accordance with IFRS 15.

- **IFRIC 4 Determining whether an Arrangement contains a Lease** requires the allocation of an arrangement’s consideration between a lease and other components within a contractual arrangement using a relative fair value approach.\(^{15}\) It is important to note that the IASB is considering changes to IAS 17 and its related Interpretations. As a result, the manner in which IFRS 15 interacts with the requirements for leases may change in the future. However, we currently anticipate that IFRS 15 will be effective before or at the same time that any new leasing standard will be effective.

\(^{15}\) See IFRIC 4.13
If a component of the arrangement is covered by another standard or interpretation, but that standard or interpretation does not specify how to separate and/or initially measure that component, the entity will apply IFRS 15 to separate and/or measure each component. For example, specific requirements do not exist for the separation and measurement of the different parts of an arrangement when an entity sells a business and also enters into a long-term supply agreement with the other party. See Section 6.6 for further discussion on the effect on the allocation of arrangement consideration when an arrangement includes both revenue and non-revenue components.

The standard also specifies the accounting requirements for certain costs, such as the incremental costs of obtaining a contract and the costs of fulfilling a contract. However, the standard is clear that these requirements only apply if there are no other applicable requirements in IFRS for those costs. See Section 8.3 for further discussion on the requirements relating to contract costs in the standard.

In addition, as part of the consequential amendments associated with IFRS 15, the existing requirements for the recognition of a gain or loss on the disposal of a non-financial asset (e.g., assets within the scope of IAS 16 Property, Plant and Equipment or IAS 38 Intangible Assets) will be amended. The recognition and measurement requirements in IFRS 15 will apply when recognising and measuring any gains or losses on disposal of such non-financial assets, when that disposal is not in the ordinary course of business. An entity will be required to look to the control model in IFRS 15 to determine when to derecognise the non-financial asset (i.e., when control is transferred). The entity will estimate consideration to measure the gain or loss following the requirements in IFRS 15 for determining the transaction price. Any subsequent changes to the estimated consideration will also be accounted for following the requirements of IFRS 15. The measurement of any gain or loss resulting from the consequential amendments may differ from the gain or loss measured by following the current requirements in IAS 18.

**What's changing from current IFRS?**

Entities entering into transactions that fall within the scope of multiple standards need to separate those transactions into components, so that each component can be accounted for under the relevant standards. IFRS 15 does not change this requirement.

However, under current IFRS, revenue transactions must often be separated into components that are accounted for under different revenue standards and/or interpretations (e.g., a transaction involving the sale of goods and a customer loyalty programme that falls within the scope of both IAS 18 and IFRIC 15, respectively). This will no longer be relevant as there is a single revenue recognition model under IFRS 15.

IAS 18 currently specifies the accounting treatment for the recognition and measurement of interest and dividends. Interest and dividend income are excluded from the scope of IFRS 15. Instead, the relevant recognition and measurement requirements have been moved to IFRS 9 or IAS 39.
Summary of recent TRG discussions

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

At the January 2015 TRG meeting, members of the TRG discussed whether (before applying the financial instruments standards) deferred-payment transactions that are part of Sharia-compliant instruments and transactions are within the scope of IFRS 15. The TRG members meeting in London generally agreed that Sharia-compliant instruments and transactions may be outside the scope of the standard. However, the analysis would depend on the specific facts and circumstances and may require significant judgement as contracts often differ within and between jurisdictions. The TRG members meeting in Norwalk did not discuss this issue.16

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, airport lounge access). The card issuer may also provide rewards to cardholders based on their purchases. At the July 2015 TRG meeting, members of the TRG discussed a question raised by US GAAP stakeholders regarding whether such fees and programmes are within the scope of the revenue standards, particularly when a good or service is provided to a cardholder.

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 current requirements for credit card fees. However, the observer from the US Securities and Exchange Commission (SEC) noted that the nature of the arrangement must truly be that of a credit card lending arrangement in order to be in the scope of ASC 310. As such, entities 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.

IFRS 9 and IAS 39 require 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. As such, credit card fees could be treated differently under IFRS and US GAAP.

16 TRG members attend TRG meetings either at the FASB’s office in Norwalk, Connecticut, USA or at the IASB’s office in London, UK.
<table>
<thead>
<tr>
<th><strong>Summary of recent TRG discussions (cont’d)</strong></th>
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<tbody>
<tr>
<td>TRG members in Norwalk also discussed whether cardholder rewards programmes are within the scope of ASC 606. Those TRG members generally agreed that if all consideration (i.e., credit card fees) related to the rewards programme is determined to be within 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 the facts and circumstances due to the wide variety of credit card reward programmes offered. This issue was not discussed in an IFRS context.</td>
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<tr>
<td><strong>Contributions</strong></td>
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<tr>
<td>Currently, 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 ASC 606. In March 2015, TRG members meeting in Norwalk discussed a question raised by US GAAP stakeholders and 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 in London did not discuss this issue.</td>
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3. Identify the contract with the customer

To apply the model in IFRS 15, an entity must first identify the contract, or contracts, to provide goods and services to customers. Any contracts that create enforceable rights and obligations fall within the scope of the standard. Such contracts may be written, oral or implied by the entity's customary business practice. For example, an entity’s past business practices may influence its determination of when an arrangement meets the definition of a contract with a customer. An entity that has an established practice of starting performance based on oral agreements with its customers may determine that such oral agreements meet the definition of a contract.

As a result, an entity may need to account for a contract as soon as performance begins, rather than delay revenue recognition until the arrangement is documented in a signed contract as is often the case under current practice. Certain arrangements may require a written contract to comply with jurisdictional law or trade regulation. These requirements must be considered when determining whether a contract exists.

In the Basis for Conclusions, the Boards acknowledge that the determination of whether an arrangement has created enforceable rights is a matter of law and the factors that determine enforceability may differ among jurisdictions. The Boards also clarified that, while the contract must be legally enforceable to be within the scope of the standard, the performance obligations within the contract can be based on the valid expectations of the customer, even if the promise is not enforceable. In addition, the standard clarifies that some contracts may have no fixed duration and can be terminated or modified by either party at any time. Other contracts may automatically renew on a specified periodic basis. Entities are required to apply IFRS 15 to the contractual period in which the parties have present enforceable rights and obligations.

At the March 2015 TRG meeting, members of the TRG considered issues related to partial satisfaction of performance obligations prior to identifying the contract. Their discussions on measuring progress and fulfilment costs are covered in more detail in Sections 7.1.4 and 8.3.2 below, respectively.

Illustration 3-1 — Oral contract

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

In this example, IT Support Co. and its customer are entering into an oral agreement, which is legally enforceable in this jurisdiction, for IT Support Co. to repair the customer’s PC and for the customer to provide consideration by

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17 IFRS 15.BC32
3.1 Attributes of a contract

To help entities determine whether (and when) their arrangements with customers are contracts within the scope of the standard, the Boards identified certain attributes that must be present. These criteria are assessed at the inception of the arrangement. If the criteria are met at that time, an entity does not reassess these criteria unless there is an indication of a significant change in facts and circumstances.\(^{18}\) For example, if the customer’s ability to pay significantly deteriorates, an entity would have to reassess whether it is probable that the entity will collect the consideration for which it is entitled in exchange for transferring the remaining goods and services under the contract. The updated assessment is prospective in nature and would not change the conclusions associated with goods and services already transferred.

If the criteria are not met, the arrangement is not considered a revenue contract and the requirements discussed in Section 3.4 must be applied. However, entities are required to continue assessing the criteria throughout the term of the arrangement to determine if they are subsequently met. Once met, the model in IFRS 15 would apply, rather than the requirements discussed in Section 3.4. IFRS 15 includes the following criteria:

**Extract from IFRS 15**

9. An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

(a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;

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

(c) the entity can identify the payment terms for the goods or services to be transferred;

(d) the contract has commercial substance (i.e., the risk, timing or amount of the entity’s future cash flows is expected to change as a result of the contract); and

(e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer’s ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see paragraph 52).

\(^{18}\) IFRS 15.14
3.1.1 Parties have approved the contract and are committed to perform their respective obligations

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

In addition to approving the contract, the entity must also be able to conclude that both parties are committed to perform their respective obligations. That is, the entity must be committed to providing the promised goods or services. In addition, the customer must be committed to purchasing those promised goods and services. In the Basis for Conclusions, the Boards clarified that an entity and a customer do not always have to be committed to fulfilling all of their respective rights and obligations for a contract to meet this requirement. For example, the Boards cited a supply agreement between two parties that includes stated minimums. The customer does not always buy the required minimum quantity and the entity does not always enforce its right to require the customer to purchase the minimum quantity. Regardless, the Boards stated that, in such situations, it may still be possible for the entity to determine that there is sufficient evidence to demonstrate that the parties are substantially committed to the contract.

Termination clauses are an important consideration when determining whether both parties are committed to perform under a contract and, consequently, whether a contract exists. If each party has the unilateral right to terminate a ‘wholly unperformed’ contract without compensating the counterparty, the standard states that, for the purposes of IFRS 15, a contract does not exist and its accounting and disclosure requirements would not apply. If the vendor has not provided any of the contracted goods or services and has not received (or is not entitled to receive) any of the contracted consideration, the contract is considered to be ‘wholly unperformed’.

The Boards decided the standard should not apply in circumstances where a contract is wholly unperformed because those arrangements would not affect an entity’s financial position or performance until either party performs. However, if only one party has the right to terminate a contract, such a contract is within the scope of IFRS 15 because there could be an effect on an entity’s financial position and performance. If, for example, only the customer has the right to terminate a wholly unperformed contract without penalty, the Boards indicated that “the entity is obliged to stand-ready to perform at the discretion of the customer. Similarly, if only the entity could terminate the wholly unperformed contract without penalty, it has an enforceable right to payment from the customer if it chooses to perform.” See below for further discussion on termination clauses. This criterion does not address collectability. That topic is addressed in a separate criterion and is discussed in Section 3.1.5.

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19 IFRS 15.BC35  
20 IFRS 15.BC36  
21 IFRS 15.BC50
What’s changing from current IFRS?

Current IFRS does not provide specific application guidance on oral contracts. However, entities are required to consider the underlying substance and economic reality of an arrangement and not merely its legal form. The Conceptual Framework for Financial Reporting states that representing a legal form that differs from the economic substance of the underlying economic phenomenon may not result in a faithful representation.22

Despite the focus on substance over form in IFRS, treating oral or implied agreements as contracts may be a significant change in practice for some entities. It may lead to earlier accounting for oral agreements, i.e., not waiting until such agreements are formally documented.

Summary of recent TRG discussions

Evaluating termination clauses when determining the duration of a contract

As discussed in Section 3 above, entities are required to apply IFRS 15 to the contractual period in which the parties have present enforceable rights and obligations.23 Furthermore, as discussed above, termination clauses are an important consideration when determining whether the parties are committed to perform under a contract and, consequently, whether a contract, as defined by the standards, exists.24 Since termination clauses provide information about each party’s commitment to the arrangement, stakeholders raised questions about how such clauses should be evaluated when determining the duration of the contract. Specifically, stakeholders asked whether the contractual period should be restricted to reflect the expected termination date if each party to the contract has a unilateral enforceable right to terminate the contract. This is important as the duration of the contract can affect the amount of revenue recognised each period.

Members of the TRG discussed this issue in October 2014. The agenda paper25 for that meeting noted that the requirement (in IFRS 15.11) to apply the standard to the contractual period in which the parties have present enforceable rights and obligations does not explicitly explain how termination penalties should be considered. However, the Boards’ staff noted that some stakeholders have asserted that this requirement, together with the requirement for wholly unperformed contracts (in IFRS 15.12) suggest that “a contract continues to exist during the specified contractual period even if each party to the contract has the unilateral enforceable right to terminate the contract at any time during the specified contractual period by compensating the other party. This is because enforceable rights and obligations exist throughout the contractual period, evidenced by the fact that compensation would be required to terminate the contract. In other words, on termination, parties to the contract waive those enforceable rights and avoid their obligations by paying compensation.” Some stakeholders also pointed to the requirements for determining the transaction price, which require that the entity assumes the contract will not be cancelled.26 However, the Boards’ staff noted that the Basis for Conclusions clarifies that an entity applies this requirement after identifying the contract with the customer.27

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23 IFRS 15.11
24 IFRS 15.12
25 TRG Agenda paper 10, Contract enforceability and termination clauses, 31 October 2014
26 IFRS 15.49
27 IFRS 15.BC186
Summary of recent TRG discussions (cont’d)

TRG members generally agreed with the conclusions reached in the examples included in the agenda paper on this topic.\textsuperscript{28} 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).

3.1.2 Each party’s rights can be identified

This criterion is relatively straightforward. If the goods and services to be provided in the arrangement cannot be identified, it is not possible to conclude that an entity has a contract within the scope of IFRS 15. The Boards indicated that if the promised goods and services cannot be identified, the transfer of control of those goods and services also cannot be assessed.\textsuperscript{29}

3.1.3 Payment terms are identified

Identifying the payment terms does not require that the transaction price be fixed or stated in the contract with the customer. As long as there is an enforceable right to payment (i.e., enforceability as a matter of law) and the contract contains sufficient information to enable the entity to estimate the transaction price (see further discussion in Section 5), the contract would qualify for accounting under the standard (assuming the remaining criteria set out in IFRS 15.9 in the extract in Section 3.1 above, have been met).

3.1.4 Commercial substance

The Boards included a criterion that requires arrangements to have commercial substance (i.e., the risk, timing or amount of the entity’s future cash flows is expected to change as a result of the contract) to prevent entities from artificially inflating revenue.\textsuperscript{30} The model in IFRS 15 does not apply if an arrangement does not have commercial substance. Historically, some entities in high-growth industries allegedly engaged in transactions in which goods and services were transferred back and forth between the same entities in an attempt to show higher transaction volume and gross revenue (sometimes known as ‘round-tripping’). This is also a risk in arrangements that involve non-cash consideration.

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

In a change from the existing requirements in SIC-31, IFRS 15 does not contain requirements specific to advertising barter transactions. We anticipate entities will need to carefully consider the commercial substance criterion when evaluating these types of transactions.

\textsuperscript{28} TRG Agenda paper 11, October 2014 Meeting - Summary of Issues Discussed and Next Steps, dated 26 January 2015

\textsuperscript{29} IFRS 15.BC37

\textsuperscript{30} IFRS 15.BC40
3.1.5 Collectability

Under IFRS 15, collectability refers to the customer’s ability and intent to pay the amount of consideration to which the entity expects to be entitled in exchange for the goods and services that will be transferred to the customer. The Boards concluded that assessing a customer’s credit risk is an important part in determining whether a contract is valid. That is, the Boards believe that it is a key part in determining the extent to which the customer has the ability and the intent to pay the expected consideration.\(^{31}\)

This criterion essentially acts as a collectability threshold. The standard requires an entity to evaluate at contract inception (and when significant facts and circumstances change) whether it is probable that it will collect the consideration it expects to be entitled in exchange for the goods or services that will be transferred to a customer. This is consistent with today’s requirements, where revenue recognition is permitted only when it is probable that the economic benefits associated with the transaction will flow to the entity (assuming other basic revenue recognition criteria have been met).

For purposes of this analysis, the meaning of the term ‘probable’ is consistent with the existing definition in IFRS, i.e., “more likely than not”.\(^{32}\) Note, for US GAAP preparers, the standard also uses the term ‘probable’. However, ‘probable’ under US GAAP is a higher threshold than under IFRS.\(^{33}\) The customer’s ability to pay a specified amount of consideration (based on the amount the entity expects to be entitled in exchange for the goods and services that will be transferred to the customer and the customer’s intention to pay the consideration when it becomes payable) is assessed. All facts and circumstances need to be considered in the analysis. If it is not probable that the entity will collect amounts due, the model in IFRS 15 is not applied to the contract until the concerns about collectability have been resolved (see Section 3.4 for further discussion).

It is important to note that collectability may be assessed based on an amount of consideration that is not the stated total contract price. For example, the amount assessed may be less than the stated total contract price if an entity concludes that it has offered, or is willing to accept, a price concession or other discount. Such concessions or discounts are forms of variable consideration (see Section 5.1) that an entity would estimate at contract inception and deduct from the contract price to determine the transaction price. The estimated transaction price would then be assessed for collectability. The following illustrates these concepts:

<table>
<thead>
<tr>
<th></th>
<th>CU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stated total contract price</td>
<td>2,000,000</td>
</tr>
<tr>
<td>Price concession - amount entity estimates it will offer or accept as a reduction to the contractual price</td>
<td>(200,000)</td>
</tr>
<tr>
<td><strong>Transaction price</strong></td>
<td><strong>1,800,000</strong></td>
</tr>
</tbody>
</table>

\(^{31}\) IFRS 15.BC42

\(^{32}\) IFRS 5 Appendix A

\(^{33}\) For US GAAP, the term ‘probable’ is defined in the master glossary of the US Accounting Standards Codification as “the future event or events are likely to occur”
**What’s changing from current IFRS?**

While this requirement is similar to the current requirements in IAS 18, applying the concept to a portion of the contractual amount, instead of the total, may be a significant change. Before revenue can be recognised under IAS 18, it must be probable that the economic benefits associated with the transaction will flow to the entity. In practice, entities likely consider the entire contractually agreed consideration under IAS 18. If so, the requirements in IFRS 15 could result in the earlier recognition of revenue for a contract in which a portion of the contract price (but not the entire amount) is considered to be at risk.

The standard provides the following example of when an implicit price concession exists and, as a result, the consideration amount is not the stated contract amount:

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**Extract from IFRS 15**

**Example 2 — Consideration is not the stated price—implicit price concession** (IFRS 15.IE7-IE9)

An entity sells 1,000 units of a prescription drug to a customer for promised consideration of CU1 million. This is the entity’s first sale to a customer in a new region, which is experiencing significant economic difficulty. Thus, the entity expects that it will not be able to collect from the customer the full amount of the promised consideration. Despite the possibility of not collecting the full amount, the entity expects the region’s economy to recover over the next two to three years and determines that a relationship with the customer could help it to forge relationships with other potential customers in the region.

When assessing whether the criterion in paragraph 9(e) of IFRS 15 is met, the entity also considers paragraphs 47 and 52(b) of IFRS 15. Based on the assessment of the facts and circumstances, the entity determines that it expects to provide a price concession and accept a lower amount of consideration from the customer. Accordingly, the entity concludes that the transaction price is not CU1 million and, therefore, the promised consideration is variable. The entity estimates the variable consideration and determines that it expects to be entitled to CU400,000.

The entity considers the customer’s ability and intention to pay the consideration and concludes that even though the region is experiencing economic difficulty, it is probable that it will collect CU400,000 from the customer. Consequently, the entity concludes that the criterion in paragraph 9(e) of IFRS 15 is met based on an estimate of variable consideration of CU400,000. In addition, on the basis of an evaluation of the contract terms and other facts and circumstances, the entity concludes that the other criteria in paragraph 9 of IFRS 15 are also met. Consequently, the entity accounts for the contract with the customer in accordance with the requirements in IFRS 15.

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34 IAS 18. 14(b), 18, 20(b)
How we see it

Entities may find it challenging to apply the collectability criterion. The Boards have indicated that if an entity believes it will receive partial payment for performance, then that may be sufficient to determine the arrangement meets the definition of a contract (and that the expected shortfall of consideration is more akin to an implied price concession, see Section 5.1.1).

Summary of recent TRG discussions

At the January 2015 TRG meeting, members of the TRG generally agreed that entities would need to exercise judgement when considering the collectability criterion. 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.

In September 2015, the FASB proposed an amendment to its standard to refine the requirements of the Step 1 collectability threshold and to add examples to clarify that an entity would consider the probability of collecting the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer, rather than the total amount promised. The FASB also proposed clarifying that an entity may consider its ability to manage its exposure to credit risk (e.g., through advance payments, the right to stop transferring additional goods or services) as part of the collectability assessment. For example, in a service contract with a stated three-year term that either party could terminate with two months’ notice without penalty, the evaluation would only reflect the two-month non-cancellable period in the contract. However, this analysis would only determine whether the entity has a valid contract under ASC 606 and would not affect the contractual term that is considered when applying the rest of the requirements in ASC 606 (e.g., for purposes of determining or allocating the transaction price).

When the IASB considered this issue, it noted that the collectability assessment ‘requires an entity to consider the relative position of the entity’s contractual rights to the consideration and the entity’s performance obligations. That assessment considers the entity’s exposure to the customer’s credit risk and the business practices available to the entity to manage its exposure to credit risk throughout the contract. For example, an entity may be able to stop providing goods or services to the customer or require advance payments. This is consistent with the explanation of the Boards’ considerations as described in IFRS 15.BC46 – that paragraph states that, if the customer were to fail to perform as promised and consequently the entity would respond to the customer’s actions by not transferring any further goods or services to the customer, the entity would not consider the likelihood of payment for those goods or services that would not be transferred.’ The IASB noted that sufficient guidance exists within IFRS 15 and in the explanatory material in the Basis for Conclusions. As such, the IASB decided not to propose any clarifications or amendments to IFRS 15 in respect of the Step 1 collectability threshold.

35 IFRS 15.9(e) and IFRS 15.BC46
36 Exposure draft ED/2015/6, Clarifications to IFRS 15, paragraph BC90 – BC91
Assessing collectability for a portfolio of contracts

At the January 2015 TRG meeting, members of the TRG considered how an entity would assess collectability if it has a portfolio of contracts (see Section 3.2 for further discussion on portfolios). 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 of the 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.

Determining when to reassess collectability

As discussed above, IFRS 15 requires an entity to reassess its conclusions about collectability (i.e., whether it is probable that it will collect the consideration to which it expects to be entitled) when significant facts and circumstances change. At the January 2015 TRG meeting, members of the TRG discussed when such a reassessment is required. TRG members generally agreed that entities will need to exercise judgement to determine whether changes in the facts and circumstances require a reassessment of collectability. Judgement will also be needed to determine whether changes in facts and circumstances are significant enough to indicate that a contract no longer exists under the standard.

3.2 Combining contracts

In most cases, entities will apply the model to individual contracts with a customer. However, the standard requires entities to combine contracts entered into at, or near, the same time with the same customer if they meet one or more of the criteria outlined below:

Extract from IFRS 15

17. An entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:

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

(b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or

(c) the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation in accordance with paragraphs 22–30.

In the Basis for Conclusions, the Boards have clarified that negotiating multiple contracts at the same time is not sufficient evidence to demonstrate that the contracts represent a single arrangement for accounting purposes.\(^{37}\)

\(^{37}\) IFRS 15.BC73
There may be situations in which the entity elects to combine multiple contracts in order to facilitate revenue recognition. For example, the standard states that an entity can account for a portfolio of similar contracts together if it expects that the result will not differ materially from the result of applying the standard to the individual contracts. In concluding that the ‘portfolio approach’ is not materially different, the Boards made it clear that they did not intend for an entity to quantitatively evaluate every possible outcome. Instead, they indicated that an entity should be able to take a reasonable approach to determine the portfolios that would be appropriate for its types of customers. In addition, an entity should use judgement to select the appropriate size and composition of the portfolio.\textsuperscript{38}

**What’s changing from current IFRS?**

IFRS 15 provides more requirements on when to combine contracts than IAS 18. IFRS preparers currently have a similar requirement in IAS 11. The primary difference between IAS 11 and IFRS 15 is the criterion in IFRS 15.17(c), which considers a performance obligation across different contracts. In contrast, IAS 11 considers concurrent or sequential performance.\textsuperscript{39}

Overall, the criteria are generally consistent with the underlying principles in the existing revenue standards on combining contracts. However, unlike IAS 18, the new standard explicitly requires an entity to combine contracts if the criteria in IFRS 15.17 are met. Therefore, some entities that do not currently combine contracts may need to do so.

### 3.3 Contract modifications

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

**Extract from IFRS 15**

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

19. A contract modification may exist even though the parties to the contract have a dispute about the scope or price (or both) of the modification or the parties have approved a change in the scope of the contract but have not yet determined the corresponding change in price. In determining whether the rights and obligations that are created or changed by a modification are enforceable, an entity shall consider all relevant facts and circumstances including the terms of the contract and other evidence. If the parties to a

\textsuperscript{38} IFRS 15.4

\textsuperscript{39} IAS 11.9(c)
contract have approved a change in the scope of the contract but have not yet
determined the corresponding change in price, an entity shall estimate the
change to the transaction price arising from the modification in accordance
with paragraphs 50-54 on estimating variable consideration and paragraphs
56-58 on constraining estimates of variable consideration.

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

The standard provides the following example to illustrate this point:

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

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

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

Once an entity has determined that a contract has been modified, the entity
determines the appropriate accounting treatment for the modification. Certain
modifications are treated as separate stand-alone contracts, while others are
combined with the original contract. The standard includes the following
requirements for determining the appropriate accounting treatment:
Extract from IFRS 15

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

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

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

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

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

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

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

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

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

The requirement to determine whether to treat a change in contractual terms as a separate contract or a modification to an existing contract is relatively consistent with the requirements in IAS 11 for construction contracts. In contrast, IAS 18 does not provide detailed application guidance on how to determine whether a change in contractual terms is treated as a separate contract or a modification to an existing contract. Therefore, the requirements in IFRS 15 could result in a change in practice for some entities. It is important to note, however, that when assessing how to account for the contract modification, an entity must consider how any revisions to promised goods or services interact with the rest of the contract. That is, although a contract modification may add a new good or service that would be distinct in a stand-alone transaction, the new performance obligation may not be distinct when it is part of a contract modification. For example, in a building renovation project, a customer may request a contract modification to add a new room. The construction firm may commonly sell the construction of an added room on a stand-alone basis, which would indicate that the service is distinct. However, when that service is added to an existing contract and the entity has already determined that the entire project is a single performance obligation, the added goods and services would normally be combined with the existing bundle of goods and services.

### 3.3.1 Contract modification represents a separate contract

Certain contract modifications are treated as separate contracts. For these modifications, the original contract is not affected by the modification and the revenue recognised to date on the original contract is not adjusted. Furthermore, any performance obligations remaining under the original contract continue to be accounted for under the original contract.

Two criteria must be met for a modification to be treated as a separate contract. The first is that the additional promised goods or services in the modification must be distinct from the promised goods or services in the original contract. This assessment is done in accordance with IFRS 15’s general requirements for determining whether promised goods or services are distinct (see Section 4.2). Only modifications that add distinct goods or services to the arrangement can be treated as separate contracts. Arrangements that reduce the amount of promised goods or services or change the scope of the original promised goods and services cannot, by their very nature, be considered separate contracts. Instead, they would be considered modifications of the original contract (see Section 3.3.2).

The second requirement is that the amount of consideration expected for the added promised goods or services must reflect the stand-alone selling prices of those promised goods or services. However, when determining the stand-alone selling price entities have some flexibility to adjust the stand-alone selling price, depending on the facts and circumstances. For example, a vendor may give an existing customer a discount on additional goods because the vendor would not incur selling-related costs that it would typically incur for new customers. In this example, the entity (vendor) may determine that the incremental transaction consideration meets the requirement, even though the discounted price is less than the stand-alone selling price of that good or service for a new customer. In

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40 IAS 11.13  
41 IFRS 15.20  
42 IFRS 15.20(a)
another example, an entity may conclude that, with the additional purchases, the customer qualifies for a volume-based discount.\(^\text{43}\)

See Case A of Example 5 from the standard (provided in Section 3.3.2) for an illustration of a contract modification that represents a separate contract.

### 3.3.2 Contract modification is not a separate contract

Contract modifications that do not meet the criteria discussed in Section 3.3.1 are considered changes to the original contract and are not treated as separate contracts. This includes contract modifications that modify or remove previously agreed-upon goods and services. An entity would account for the effects of these modifications differently, depending on which of the three scenarios described in IFRS 15.21 (see the extract in Section 3.3) most closely aligns with the facts and circumstances of the modification:

- After the contract modification, if the remaining goods and services are distinct from the goods or services transferred on, or before, the contract modification, the entity accounts for the modification as if it were a termination of the old contract and the creation of a new contract. For these modifications, the revenue recognised to date on the original contract (i.e., the amount associated with the completed performance obligations) is not adjusted. Instead, the remaining portion of the original contract and the modification are accounted for, together, on a prospective basis by allocating the remaining consideration to the remaining performance obligations. See Case B of Example 5 from the standard, in the extract below, for an illustration of this scenario.

- The remaining goods and services to be provided after the contract modification may not be distinct from those goods and services already provided and, therefore, form part of a single performance obligation that is partially satisfied at the date of modification. If this is the case, the entity accounts for the contract modification as if it were part of the original contract. The entity adjusts revenue previously recognised (either up or down) to reflect the effect that the contract modification has on the transaction price and the measure of progress (i.e., the revenue adjustment is made on a cumulative catch-up basis). See Example 8 from the standard, in the extract below, for an illustration of this type of modification.

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

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\(^{43}\) IFRS 15.20(b)
The standard includes the following examples to illustrate these concepts:

**Extract from IFRS 15**

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

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

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

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

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

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

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

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

Consequently, the amount recognised as revenue for each of the remaining products is a blended price of CU93.33 \(((CU100 × 60 \text{ products not yet transferred under the original contract}) + (CU80 × 30 \text{ products to be transferred under the contract modification})) ÷ 90 \text{ remaining products})\).
Extract from IFRS 15

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

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

<table>
<thead>
<tr>
<th>CU</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction price</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Expected costs</td>
<td>700,000</td>
</tr>
<tr>
<td>Expected profit (30%)</td>
<td>300,000</td>
</tr>
</tbody>
</table>

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

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

<table>
<thead>
<tr>
<th>CU</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>600,000</td>
</tr>
<tr>
<td>Costs</td>
<td>420,000</td>
</tr>
<tr>
<td>Gross profit</td>
<td>180,000</td>
</tr>
</tbody>
</table>

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

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

How we see it
Entities will need to carefully evaluate performance obligations at the date of a modification to determine whether the remaining goods or services to be transferred are distinct. This assessment is important because the accounting treatment can vary significantly depending on the results.

3.4 Arrangements that do not meet the definition of a contract under the standard
If an arrangement does not meet the criteria to be considered a contract under the standard, it must be accounted for as follows:

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

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

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

16. An entity shall recognise the consideration received from a customer as a liability until one of the events in paragraph 15 occurs or until the criteria in paragraph 9 are subsequently met (see paragraph 14). Depending on the facts and circumstances relating to the contract, the liability recognised represents the entity’s obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer.
As noted in the Basis for Conclusions, the Boards decided to include the requirements in the extract above to prevent entities from seeking alternative guidance or improperly analogising to the model in IFRS 15 in circumstances in which an executed contract does not meet the criteria in IFRS 15.9 (as discussed in Section 3.1). Consequently, the Boards specified that, in cases in which the contract does not meet the criteria, an entity only recognises non-refundable consideration received as revenue when one of the events outlined above has occurred (i.e., full performance and substantially all consideration received or the contract has been terminated) or the contract subsequently meets the criteria in IFRS 15.9. Until that happens, any consideration received from the customer is initially accounted for as a liability (not revenue) and the liability is measured at the amount of consideration received from the customer.

In the Basis for Conclusions, the Boards indicated they intended this accounting to be “similar to the ‘deposit method’ that was previously included in US GAAP and applied when there was no consummation of a sale”.

The standard includes the following example to illustrate this concept:

**Extract from IFRS 15**

**Example 1 — Collectability of the consideration (IFRS 15.IE3-Ie6)**

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

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

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

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

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

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

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44 IFRS 15.BC47
45 IFRS 115.BC48
Because the criteria in paragraph 9 of IFRS 15 are not met, the entity applies paragraphs 15–16 of IFRS 15 to determine the accounting for the non-refundable deposit of CU50,000. The entity observes that none of the events described in paragraph 15 have occurred—that is, the entity has not received substantially all of the consideration and it has not terminated the contract. Consequently, in accordance with paragraph 16, the entity accounts for the non-refundable CU50,000 payment as a deposit liability. The entity continues to account for the initial deposit, as well as any future payments of principal and interest, as a deposit liability, until such time that the entity concludes that the criteria in paragraph 9 are met (ie the entity is able to conclude that it is probable that the entity will collect the consideration) or one of the events in paragraph 15 has occurred. The entity continues to assess the contract in accordance with paragraph 14 to determine whether the criteria in paragraph 9 are subsequently met or whether the events in paragraph 15 of IFRS 15 have occurred.

As noted above, when an arrangement does not meet the criteria to be considered a contract under the standard, an entity can only recognise non-refundable consideration received as revenue when the entity has completed performance and received substantially all consideration or the contract has been terminated. At the January 2015 TRG meeting, several TRG members noted that this requirement could indefinitely delay recognition of non-refundable cash consideration received in a number of situations (e.g., a month-to-month service arrangement when the entity continues to perform). Those TRG members questioned whether this was the Boards’ intent.

The IASB considered this issue, but decided not to propose any clarifications or amendments to IFRS 15. In the Basis for Conclusions to its July 2015 exposure draft, the IASB noted that contracts often specify that an entity has the right to terminate the contract in the event of non-payment by the customer and that this would not generally affect the entity’s rights to recover any amounts owed by the customer. The IASB also noted that “an entity’s decision to stop pursuing collection would not typically affect the entity’s rights and the customer’s obligations under the contract with respect to the consideration owed by the customer. On this basis, the IASB concluded that the existing guidance in IFRS 15 is sufficient for an entity to conclude that a contract is terminated when it stops providing goods or services to the customer without any additional clarification.”

In response to the issue highlighted by TRG members, in September 2015, the FASB proposed an amendment to say that, when an arrangement does not meet the criteria to be a contract under ASC 606 (e.g., collectability is not probable), 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. Adding this to ASC 606 would create a third triggering event, in addition to the two already described in the standard.

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46 Exposure draft ED/2015/6, Clarifications to IFRS 15, paragraph BC96.
47 IFRS 15.15.
4. Identify the performance obligations in the contract

To apply the standard, an entity must identify the promised goods and services within the contract and determine which of those goods and services are separate, or distinct, performance obligations (i.e., the unit of account for the purposes of applying the standard). Each of these concepts is discussed below.

In July 2015, the IASB proposed to amend some of the existing illustrative examples that accompany IFRS 15, to clarify how an entity would determine when a promised good or service is ‘separately identifiable’ from other promises in the contract (i.e., distinct within the context of the contract).\(^\text{48}\) In May 2015, the FASB exposed several changes to its standard on identifying performance obligations for public comment, including clarifications regarding when a promised good or service is distinct within the context of the contract. The Boards’ proposals are discussed further in Sections 4.1, 4.1.1, 4.2 and 4.2.1 below.

4.1 Identifying the promised goods and services in the contract

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

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**Extract from IFRS 15**

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

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

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

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

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

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

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\(^{48}\) Exposure draft ED/2015/6, *Clarifications to IFRS 15*, paragraph BC9
Promises in contracts with customers

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

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

Distinct goods or services

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

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

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

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

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

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

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

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

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

(i) granting licences (see paragraphs B52-B63); and

(j) granting options to purchase additional goods or services (when those options provide a customer with a material right, as described in paragraphs B39-B43).
The standard requires an entity to identify, at contract inception, all promised goods and services and determine which of these promised goods or services (or bundle of goods and services) represent separate performance obligations. Current IFRS does not specifically address contracts with multiple deliverables, focusing instead on identifying the transaction. This includes identifying separate elements so as to reflect the substance of the transaction. As a result, many IFRS preparers have looked to US GAAP for guidance in this area. Current US GAAP requires entities to identify the ‘deliverables’ within an arrangement, but does not define that term. In contrast, IFRS 15 indicates the types of items that may be goods or services promised in the contract. In addition, the standard makes clear that certain activities are not promised goods or services, such as activities that an entity must perform to satisfy its obligation to deliver the promised goods and services (e.g., internal administrative activities).

The Boards noted that, in many cases, all of the promised goods or services in a contract might be identified explicitly in that contract. However, in other cases, promises to provide goods or services might be implied by the entity’s customary business practices. The standard indicates that when an entity identifies the promises in a contract, it considers whether there is a valid expectation on the part of the customer that the entity will provide a good or service. That is, the notion of a performance obligation also includes constructive performance obligations based on factors outside a written contract (e.g., past business practice, industry norms). The Boards also noted that implied promises in a contract do not need to be enforceable by law. If the customer has a valid expectation, the customer would view those promises as part of the negotiated exchange. The Boards provided examples of such promised goods or services in its Basis for Conclusions, including ‘free’ handsets provided by telecommunication entities, ‘free’ maintenance provided by automotive manufacturers and customer loyalty points awarded by supermarkets, airlines, and hotels. Although the entity may consider those goods or services to be marketing incentives or incidental goods or services, the Boards concluded they are goods or services for which the customer pays and to which the entity allocates consideration (i.e., identify as performance obligations) for the purpose of recognising revenue.

As noted in the Basis for Conclusions, the Boards decided that all goods or services promised to a customer, as a result of a contract, give rise to performance obligations, including a promise to provide a good or service in the future. A customer may have a right to receive goods or services in the future that it can resell or provide to its own customers. Such a right may represent promises to the customer if it existed at the time that the parties agreed to the contract. These types of promises exist in distribution networks in various industries and are common in the automotive industry.

**How we see it**

The inclusion of guidance on what types of items may be goods and services in a contract (rather than internal administrative activities that an entity performs to provide the promised goods and services) is an improvement from current IFRS. This should be helpful when applying the standard.

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49 IAS 18.13  
50 IFRS 15.BC87  
51 IFRS 15.BC88  
52 IFRS 15.BC92
In May 2015, the FASB proposed two clarifications to the requirements for identifying promised goods and services. The standard currently states that promised goods or services are not limited to explicit promises in a contract, but could be created by ‘valid expectation of the customer’. As proposed, this term would be replaced in ASC 606 with ‘reasonable expectation of the customer’, to avoid confusion because the standard states that promises to provide goods or services do not need to be enforceable (although the overall arrangement needs to be enforceable to be a contract, as defined under the standard). The FASB also decided to review its standard and make changes to ensure that the terms ‘promised goods or services’ and ‘performance obligations’ are used correctly in all instances.\(^{53}\)

The IASB did not propose similar clarifications to IFRS 15 in its July 2015 exposure draft. In the Basis for Conclusions to its exposure draft, the Board noted that use of the term ‘valid’ is consistent with the requirements for constructive obligations in IAS 37 Provisions, Contingent Liabilities and Contingent Assets. As a result, the Board concluded that proposing a similar amendment to IFRS 15 would create inconsistencies within IFRS.\(^{54}\)

The standard includes the following example to illustrate how to apply the requirements for identifying performance obligations in various scenarios. In July 2015, the IASB proposed clarifications to this example, but these have not been reflected in the text below.

### Extract from IFRS 15

**Example 12 — Explicit and implicit promises in a contract (IFRS 15.IE59-IE65)**

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

**Case A—Explicit promise of service**

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

Because the promise of maintenance services is a promise to transfer goods or services in the future and is part of the negotiated exchange between the entity and the distributor, the entity determines that the promise to provide maintenance services is a performance obligation (see paragraph 26(g) of IFRS 15). The entity concludes that the promise would represent a performance obligation regardless of whether the entity, the distributor, or a third party provides the service. Consequently, the entity allocates a portion of the transaction price to the promise to provide maintenance services.


\(^{54}\) Exposure draft ED/2015/6, *Clarifications to IFRS 15*, paragraph BC25
Case B—Implicit promise of service

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

However, on the basis of its customary business practice, the entity determines at contract inception that it has made an implicit promise to provide maintenance services as part of the negotiated exchange with the distributor. That is, the entity’s past practices of providing these services create valid expectations of the entity’s customers (i.e., the distributor and end customers) in accordance with paragraph 24 of IFRS 15. Consequently, the entity identifies the promise of maintenance services as a performance obligation to which it allocates a portion of the transaction price.

Case C—Services are not a performance obligation

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

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

4.1.1 Identifying promised goods or services that are not identified as deliverables under current revenue requirements

Following the issuance of the new revenue standards, stakeholders questioned whether they will have to identify promised goods or services under the new standards that they do not identify as deliverables today. The question had been raised, in part, because the Boards said in the Basis for Conclusions that they “decided not to exempt an entity from accounting for performance obligations that the entity might regard as being perfunctory or inconsequential. Instead, an entity should assess whether those performance obligations are immaterial to its financial statements.”

In January 2015, the TRG members discussed this issue and 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

55 IFRS 15.BC90
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.

The Boards subsequently considered the TRG members’ discussion and agreed that they do not expect entities to identify significantly more performance obligations than the deliverables that they identify today. However, to address stakeholders’ concerns, in May 2015, the FASB proposed amending its 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 permit entities to disregard immaterial items at the contract level and not require that they be aggregated and assessed for materiality at the entity level. However, its proposal emphasises that optional goods or services continue to be accounted for in accordance with the related requirements (see Section 4.6 below).56

The IASB decided not to propose a similar amendment in its July 2015 exposure draft to avoid any risk of unintended consequences. The IASB believes the requirements of IFRS 15 are sufficiently clear and there may be broader implications to consider beyond the revenue standard. In the Basis for Conclusions to the exposure draft, the Board noted that the “TRG’s discussion highlighted that the concerns raised primarily relate to potential changes to practice under US GAAP. Previous revenue standards under IFRS do not contain similar language to the guidance issued by the staff of the US Securities and Exchange Commission on inconsequential or perfunctory performance obligations. The TRG’s discussion indicated that IFRS stakeholders can understand and apply the requirements of IFRS 15. IFRS stakeholders have not expressed concerns about making reasonable judgements when assessing the promised goods or services in a contract for the purpose of identifying performance obligations.”57

Summary of recent TRG discussions

The nature of the promise in a stand-ready obligation

As discussed in Section 4.1 above, IFRS 15 states 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”.58 Stakeholders raised questions about the nature of the promise in a ‘typical’ stand-ready obligation.

At the January 2015 TRG meeting, members of the TRG 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.

56 FASB Proposed ASU, Revenue from Contracts with Customers – Identifying Performance Obligations and Licensing, May 2015
57 Exposure draft ED/2015/6, Clarifications to IFRS 15, paragraph BC19
58 IFRS 15.26(e)
Summary of recent TRG discussions (cont’d)

A FASB staff member also 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). For the TRG members' discussion on measuring progress toward satisfaction for a stand-ready obligation that is satisfied over time see Section 7.1.4 below.

4.2 Separate performance obligations

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

To reduce the cost and complexity of applying ASC 606, in May 2015, the FASB proposed allowing entities to elect to account for the cost of shipping and handling that is performed after control of a good has been transferred to the customer as a fulfilment cost (i.e., an expense). Without such an election, an entity that has shipping arrangements with free on board terms of trade might determine that the act of shipping is a performance obligation under the new standard. If that is the case, the entity would be required to allocate a portion of the transaction price to the shipping service and recognise it when (or as) the shipping occurs.59

The IASB, however, decided not to propose similar changes to IFRS 15 when it issued its exposure draft in July 2015. In the Basis for Conclusions to that exposure draft, the Board noted that IFRS 15 “requires an entity to assess the goods or services promised in a contract with a customer in order to identify performance obligations. The introduction of a policy election would override this requirement. In addition, a policy election is applicable to all entities. Consequently, it is possible that entities with significant shipping operations could make different policy elections. This may present challenges for users of financial statements to compare the revenue reported by different entities, including those within the same industry.”60

4.2.1 Determination of ‘distinct’

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

- Assessment at the level of the individual good or service
- Assessment of the good or service within the context of the contract

Both of the following criteria must be met to conclude that the good or service is individually distinct, as discussed further below. If these criteria are met, the individual units of account must be separated.

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59  FASB Proposed ASU, Revenue from Contracts with Customers – Identifying Performance Obligations and Licensing, May 2015
60  Exposure draft ED/2015/6, Clarifications to IFRS 15, paragraph BC24
Extract from IFRS 15

27. A good or service that is promised to a customer is distinct if both of the following criteria are met:

(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and

(b) the entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the good or service is distinct within the context of the contract).

How we see it

IAS 18 indicates that an entity may need to apply its recognition criteria to separately identifiable elements in order to reflect the substance of the transaction. However, it does not provide additional application guidance for determining those separate elements. As such, the requirements in IFRS 15 may change practice.

Many IFRS preparers have developed their accounting policies by reference to US GAAP. Whether the new standard results in a change in practice may depend on which US GAAP requirements they have considered when developing their policies.

The first step of the two-step process to determine whether goods or services are distinct is similar to the principles for determining separate units of accounting under today’s US GAAP requirements in ASC 605-25 Revenue Recognition – Multiple-Element Arrangements. However, the second step (to determine if the goods or services are distinct within the context of the contract) is a new requirement. Therefore, entities may reach different conclusions about separate performance obligations under the new standard than they do under current practice.

Entities that have looked to other US GAAP requirements to develop their accounting policies, such as ASC 985-605 Software – Revenue Recognition, may also reach different conclusions under IFRS 15.

Capable of being distinct

The standard states that a customer can benefit from a good or service if the good or service could be used, consumed, sold for an amount greater than scrap value or otherwise held in a way that generates economic benefits.61 A customer may be able to benefit from some goods or services on their own or in conjunction with other readily available resources. A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events. The fact that an entity regularly sells a good or service separately indicates that a customer can benefit from that good or service on its own or with readily available resources.

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61 IFRS 15.28
As noted in the Basis for Conclusions, the assessment of whether the “customer can benefit from the goods or services on its own” is based on the characteristics of the goods or services themselves instead of how the customer might use the goods or services. As a result, an entity disregards any contractual limitations that may prevent the customer from obtaining those readily available resources from a party other than the entity when making this assessment.

**Distinct within the context of the contract**

Once an entity has determined whether a good or service is distinct based on its individual characteristics, the entity considers whether the good or service is separable from other promises in the contract. The standard provides the following requirements for making this determination:

<table>
<thead>
<tr>
<th>Extract from IFRS 15</th>
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<tbody>
<tr>
<td>29. Factors that indicate that an entity’s promise to transfer a good or service to a customer is separately identifiable (in accordance with paragraph 27(b)) include, but are not limited to, the following:</td>
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<tr>
<td>(a) the entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output for which the customer has contracted. In other words, the entity is not using the good or service as an input to produce or deliver the combined output specified by the customer.</td>
</tr>
<tr>
<td>(b) the good or service does not significantly modify or customise another good or service promised in the contract.</td>
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<tr>
<td>(c) the good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract. For example, the fact that a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services in the contract might indicate that the good or service is not highly dependent on, or highly interrelated with, those other promised goods or services.</td>
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</table>

The Basis for Conclusions notes that, typically, a good or service is not separately identifiable from other promises in the contract when an entity uses the good or service as an input into a single process or project that is the output of the contract. For example, in construction contracts, an entity may provide an integration service in addition to providing goods or services to complete the construction tasks. Although the indicator in IFRS 15.29(a) was developed in response to feedback received from the construction industry, the indicator applies to all industries.

If a promised good or service is not distinct, an entity is required to combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct.

An entity will be required to account for all the goods or services promised in a contract as a single performance obligation if the entire bundle of promised goods and services is the only performance obligation identified.

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62 IFRS 15.BC100
63 IFRS 15.BC107
The example below illustrates how an entity applies the two-step process for determining whether promised goods or services in a contract are distinct. In July 2015, the IASB proposed clarifications to this example, but these have not been reflected in the text below.

**Extract from IFRS 15**

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

**Case A – Distinct goods or services**

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

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

The entity also considers the factors in paragraph 29 of IFRS 15 and determines that the promise to transfer each good and service to the customer is separately identifiable from each of the other promises (thus the criterion in paragraph 27(b) of IFRS 15 is met). In particular, the entity observes that the installation service does not significantly modify or customise the software itself and, as such, the software and the installation service are separate outputs promised by the entity instead of inputs used to produce a combined output.

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

(a) the software licence;

(b) an installation service;

(c) software updates; and

(d) technical support.

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

Case B—Significant customisation

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

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of IFRS 15. The entity observes that the terms of the contract result in a promise to provide a significant service of integrating the licenced software into the existing software system by performing a customised installation service as specified in the contract. In other words, the entity is using the licence and the customised installation service as inputs to produce the combined output (ie a functional and integrated software system) specified in the contract (see paragraph 29(a) of IFRS 15). In addition, the software is significantly modified and customised by the service (see paragraph 29(b) of IFRS 15). Although the customised installation service can be provided by other entities, the entity determines that within the context of the contract, the promise to transfer the licence is not separately identifiable from the customised installation service and, therefore, the criterion in paragraph 27(b) of IFRS 15 (on the basis of the factors in paragraph 29 of IFRS 15) is not met. Thus, the software licence and the customised installation service are not distinct.

As in Case A, the entity concludes that the software updates and technical support are distinct from the other promises in the contract. This is because the customer can benefit from the updates and technical support either on their own or together with the other goods and services that are readily available and because the promise to transfer the software updates and the technical support to the customer are separately identifiable from each of the other promises.

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

(a) customised installation service (that includes the software licence);
(b) software updates; and
(c) technical support.

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

It is important to note that the assessment of whether a good or service is distinct must consider the specific contract with a customer. That is, an entity cannot assume that a particular good or service is distinct (or not distinct) in all instances. The manner in which promised goods and services are bundled within a contract can affect the conclusion of whether a good or service is distinct. We anticipate that entities may treat the same goods and services differently, depending on how those goods and services are bundled within a contract.
Following the issuance of the new standards, stakeholders raised several questions with the TRG regarding how an entity would determine whether a promised good or service is distinct in the context of the contract. At the October 2014 TRG meeting, members of the TRG discussed whether any individual fact pattern (e.g., a complex and/or customised design) could be determinative in the evaluation of whether a good or service is distinct within the context of a contract. While TRG members expressed varying levels of support for each of the factors in isolation, they said that all facts and circumstances would need to be considered. Without further clarification of the requirements, TRG members said there would most likely be diversity in practice.

In July 2015, the IASB proposed to amend some of the existing illustrative examples that accompany IFRS 15, to clarify how an entity would determine when a promised good or service is ‘separately identifiable’ from other promises in the contract (i.e., distinct within the context of the contract). In the Basis for Conclusions to the exposure draft, the IASB noted that the TRG members’ discussion “informed the Boards about potential diversity in stakeholders’ understanding of the principle in paragraph 27(b) and supporting factors in paragraph 29. In particular, the TRG’s discussion indicated that there is a risk of paragraph 29(c) being applied more broadly than intended, resulting in items being inappropriately combined as a single performance obligation.”

In evaluating whether a promise to transfer a good or service is separately identifiable from other promises in the contract, the IASB noted in the Basis for Conclusions to the exposure draft that an entity would not merely evaluate whether one item, by its nature, depends on the other (i.e., whether two items have a functional relationship) but would assess whether there is a transformative relationship (i.e., one that transforms the items into something that is different from the individual items) between the two items in the process of fulfilling the contract.

In May 2015, the FASB also proposed clarifying when a promised good or service is ‘separately identifiable’ from other promises in the contract (i.e., distinct within the context of the contract). The FASB’s proposals would:

- Reframe the principle for determining distinct within the context of the contract to emphasise that the evaluation hinges on whether the multiple promised goods or services work together to deliver a combined output
- Align the standard’s three indicators for determining whether a good or service is separately identifiable with this principle
  - And
- Add examples to ASC 606

References:

64 IFRS 15.27(b), 29
65 Exposure draft ED/2015/6, Clarifications to IFRS 15, paragraph BC8
66 Exposure draft ED/2015/6, Clarifications to IFRS 15, paragraph BC11
67 FASB Proposed ASU, Revenue from Contracts with Customers – Identifying Performance Obligations and Licensing, May 2015
4.2.2 Series of distinct goods and services that are substantially the same and have the same pattern of transfer

During deliberations, respondents raised questions about how certain types of promised goods or services that are transferred consecutively to a customer would be treated under the standard. Examples of such arrangements include a long-term service contract or the promise of a number of identical goods. For example, some thought it was not clear in the November 2011 exposure draft whether a three-year service contract would be accounted for as a single performance obligation, or a number of performance obligations covering smaller time periods (e.g., yearly, quarterly, monthly, daily). To address this question, the Boards clarified that even if a good or service is determined to be distinct, if that good or service is part of a series of goods and services that are substantially the same (see below) and have the same pattern of transfer, that series of goods or services must be treated as a single performance obligation if both of the following criteria are met:

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

It should be noted that in long-term service agreements when the consideration is fixed, the accounting treatment under IFRS 15 generally will not differ (assuming there is no significant financing component), regardless of whether a single performance obligation or multiple performance obligations are identified. However, in contracts involving variable consideration, concluding there is a single performance obligation, rather than multiple performance obligations, could have a significant effect (see Section 6.3).

Following the issuance of the new revenue standards, TRG members discussed a number of issues related to the series requirement, which are discussed further below. At the March 2015 TRG meeting, some TRG members noted that these issues were only some of many raised to date on the application of the series requirement. As such, TRG members in Norwalk questioned whether the fact that the series requirement is not optional negates the benefits that the Boards had intended. At the May 2015 IASB meeting, the Board’s staff highlighted the TRG members’ discussions and noted that the FASB asked its constituents, in its May 2015 exposure draft, whether the series requirement should be changed to an optional practical expedient. However, the IASB agreed not to ask its constituents a similar question in its July 2015 exposure draft. The Board noted that such an approach would represent a change to IFRS 15, rather than a clarification of the requirements.
Summary of recent TRG discussions

Assessing whether a performance obligation consists of distinct goods or services that are ‘substantially the same’

At the July 2015 TRG meeting, members of the TRG were asked to consider how an entity would assess whether a performance obligation consists of distinct goods or services that are ‘substantially the same’ in order to apply the series requirement.

The agenda paper for this discussion noted that the first step is to determine the nature of the entity’s promise in providing services to the customer:

- 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.
- If the nature of the entity’s promise is, instead, to stand ready or provide a single service for a period of time (i.e., because there is an unspecified quantity to be delivered), the evaluation would consider whether each time increment (e.g., hour, day), rather than the underlying activities, is distinct and substantially the same.

TRG members generally agreed that the analysis prepared by the Boards’ staff on this question, which primarily focused on the application of the series requirement to service contracts, will help entities understand how to determine whether a performance obligation consists of distinct goods or services that are ‘substantially the same’ under IFRS 15.

The staff’s evaluation is consistent with the examples in IFRS 15 on monthly payroll processing (see Example 13 in Section 7.1.1 below) 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, accounting services), but that would not prevent an entity from concluding that the daily management service is distinct and substantially the same.

The series requirement and consecutively transferred goods or services

As noted in the Basis for Conclusions, the Boards observed that the series requirement applies to goods or services that are delivered consecutively, rather than concurrently. The Boards determined that the standard did not need to provide a practical expedient for concurrently delivered distinct goods or services that have the same pattern of transfer. That is, in those cases, the Boards believe that an entity would not be precluded from accounting for the goods or services as if they were a single performance obligation, provided the outcome is the same as treating the goods and services as individual performance obligations.

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69 IFRS 15.BC116
Summary of recent TRG discussions

In March 2015, members of the TRG discussed whether the goods or services must be consecutively transferred to be considered under the series requirement. 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 carefully consider factors, such as the length of the gap between an entity’s transfer of goods or services, in considering whether the series requirement applies.

The series requirement versus treating the distinct goods or services as separate performance obligations

At the March 2015 TRG meeting, members of the TRG were asked whether, in order to apply the series requirement, the accounting result needs to be the same as if the underlying distinct goods and services were accounted for as separate performance obligations. Whether an entity determines a single performance obligation is created as a result of applying the series requirement or because the goods or services are not separately distinct (see Section 4.2.1 above) affects the application of various areas of IFRS 15, including contract modifications, changes in the transaction price and allocation of variable consideration.

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.

4.3 Goods and services that are not distinct

If a good or service does not meet the criteria to be considered distinct, an entity is required to combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that is distinct. The combination of multiple goods or services could result in the entity accounting for all of the goods or services promised in the contract as a single performance obligation. This could also result in an entity combining a good or service that is not considered distinct with another good or service that, on its own, would have met the criteria to be considered distinct (see Section 4.2). In July 2015, the IASB proposed clarifications to the following example, but these have not been reflected in the text below:
Extract from IFRS 15

Example 10—Goods and services are not distinct (IFRS 15.IE45-48)

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

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

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

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

4.4 Principal versus agent considerations

Some contracts result in an entity’s customer receiving goods or services from another entity that is not a direct party to the contract with the customer. The standard states that 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 good or service itself (i.e., the entity is a principal) or to arrange for another party to provide the good or service (i.e., the entity is an agent). The determination of whether the entity is acting as a principal or an agent affects the amount of revenue the entity recognises. That is, when the entity is the principal in the arrangement, the revenue recognised is the gross amount to which the entity expects to be entitled. When the entity is the agent, the revenue recognised is the net amount the entity is entitled to retain in return for its services as the agent. The entity’s fee or commission may be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

A principal’s performance obligations in a contract differ from an agent’s performance obligations. For example, 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 may be to provide the goods or services itself. Hence, the entity likely is acting as a principal and would recognise revenue in the gross amount to which it is entitled. An entity that obtains legal title of a product only momentarily before legal title is transferred to the customer is not necessarily acting as a principal. In contrast, an agent facilitates
the sale of goods or services to the customer in exchange for a fee or commission and generally does not control the goods or services for any length of time. Therefore, the agent’s performance obligation is to arrange for another party to provide the goods or services to the customer.

Because the identification of the principal in a contract is not always clear, the Boards provided indicators that a performance obligation involves an agency relationship.

### Extract from IFRS 15

B37. Indicators that an entity is an agent (and therefore does not control the good or service before it is provided to a customer) include the following:

- (a) another party is primarily responsible for fulfilling the contract;
- (b) the entity does not have inventory risk before or after the goods have been ordered by a customer, during shipping or on return;
- (c) the entity does not have discretion in establishing prices for the other party’s goods or services and, therefore, the benefit that the entity can receive from those goods or services is limited;
- (d) the entity’s consideration is in the form of a commission; and
- (e) the entity is not exposed to credit risk for the amount receivable from a customer in exchange for the other party’s goods or services.

As noted in the Basis for Conclusions, these indicators are based on indicators that were included in current revenue recognition requirements in IFRS and US GAAP. However, the indicators in IFRS 15 have a different purpose than under current IFRS in that they are based on the concepts of identifying performance obligations and the transfer of goods or services. Appropriately identifying the entity’s performance obligation in a contract is fundamental to the determination of whether the entity is acting as a principal or an agent. That is, in order for the entity to conclude it is acting as the principal in the contract, the entity must determine that it controls the goods or services promised to the customer before those goods and services are transferred to the customer. The indicators in IFRS 15 are meant to assist the entity in making that determination.

After an entity identifies its promise and determines whether it is the principal or the agent, the entity recognises revenue when it satisfies that performance obligation (as discussed in Section 7). In some contracts in which the entity is the agent, control of the goods or services promised by the agent might transfer before the customer receives the goods or services from the principal. For example, an entity might satisfy its promise to provide customers with loyalty points when those points are transferred to the customer if:

- The entity’s promise is to provide loyalty points to customers when the customer purchases goods or services from the entity
- The points entitle the customers to future discounted purchases with another party (i.e., the points represent a material right to a future discount)
- The entity determines that it is an agent (i.e., its promise is to arrange for the customers to be provided with points) and the entity does not control those points before they are transferred to the customer

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70 IFRS 15.BC382
In contrast, if the points entitle the customers to future goods or services to be provided by the entity, the entity may conclude it is not an agent. This is because the entity’s promise is to provide those future goods or services. Therefore, the entity controls both the points and the future goods or services before they are transferred to the customer. In these cases, the entity’s performance obligation may only be satisfied when the future goods or services are provided.

In other cases, the points may entitle customers to choose between future goods or services provided by either the entity or another party. In this situation, the nature of the entity’s performance obligation may not be known until the customer makes its choice. That is, until the customer has chosen the goods or services to be provided (and, therefore, whether the entity or the third party will provide those goods or services), the entity is obliged to stand ready to deliver goods or services. Therefore, the entity may not satisfy its performance obligation until it either delivers the goods or services or is no longer obliged to stand ready. If the customer subsequently chooses the goods or services from another party, the entity would need to consider whether it was acting as an agent. If so, it would recognise revenue, but only for the fee or commission that the entity receives in return for providing the services to the customer and the third party. The Boards noted that this is consistent with the current requirements in IFRIC 13 for customer loyalty programmes.\(^ {71} \)

Although an entity may be able to transfer its obligation to provide goods or services to another party, the Boards have indicated that such a transfer may not always satisfy the performance obligation. Instead, the entity evaluates whether it has created a new performance obligation to obtain a customer for the entity that assumed the obligation (i.e., whether the entity is now acting as an agent).

**How we see it**

Consistent with current practice, entities will need to carefully evaluate whether a gross or net presentation is appropriate. IFRS 15 includes application guidance on determining whether an entity is a principal or agent in an arrangement that is similar to current IFRS. Entities may, therefore, reach similar conclusions to those under current IFRS. However, the standard includes the notion of considering whether an entity has control of the goods or services as part of the evaluation, which adds an overarching principle for entities to evaluate in addition to the indicators. This may affect the assessment of whether an entity is a principal or agent in an arrangement.

\(^ {71} \) IFRS 15.BC385
The standard includes the following examples to illustrate the application of the principal versus agent application guidance. In July 2015, the IASB proposed clarifications to these examples, but these have not been reflected in the text below.

**Extract from IFRS 15**

**Example 47 — Promise to provide goods or services (entity is a principal) (IFRS 15.IE239-IE243)**

An entity negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. The entity agrees to buy a specific number of tickets and must pay for those tickets regardless of whether it is able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance.

The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are purchased; therefore there is no credit risk.

The entity also assists the customers in resolving complaints with the service provided by airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

To determine whether the entity’s performance obligation is to provide the specified goods or services itself (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), the entity considers the nature of its promise. The entity determines that its promise is to provide the customer with a ticket, which provides the right to fly on the specified flight or another flight if the specified flight is changed or cancelled. In determining whether the entity obtains control of the right to fly before control transfers to the customer and whether the entity is a principal, the entity considers the indicators in paragraph B37 of IFRS 15 as follows:

(a) the entity is primarily responsible for fulfilling the contract, which is providing the right to fly. However, the entity is not responsible for providing the flight itself, which will be provided by the airline.

(b) the entity has inventory risk for the tickets because they are purchased before they are sold to the entity’s customers and the entity is exposed to any loss as a result of not being able to sell the tickets for more than the entity’s cost.

(c) the entity has discretion in setting the sales prices for tickets to its customers.

(d) as a result of the entity’s ability to set the sales prices, the amount that the entity earns is not in the form of a commission, but instead depends on the sales price it sets and the costs of the tickets that were negotiated with the airline.

The entity concludes that its promise is to provide a ticket (i.e. a right to fly) to the customer. On the basis of the indicators in paragraph B37 of IFRS 15, the entity concludes that it controls the ticket before it is transferred to the customer. Thus, the entity concludes that it is a principal in the transaction and recognises revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred.
Example 48—Arranging for the provision of goods or services (entity is an agent) (IFRS 15.IE244-IE248)

An entity sells vouchers that entitle customers to future meals at specified restaurants. These vouchers are sold by the entity and the sales price of the voucher provides the customer with a significant discount when compared with the normal selling prices of the meals (for example, a customer pays CU100 for a voucher that entitles the customer to a meal at a restaurant that would otherwise cost CU200). The entity does not purchase vouchers in advance; instead, it purchases vouchers only as they are requested by the customers. The entity sells the vouchers through its website and the vouchers are non-refundable.

The entity and the restaurants jointly determine the prices at which the vouchers will be sold to customers. The entity is entitled to 30 per cent of the voucher price when it sells the voucher. The entity has no credit risk because the customers pay for the vouchers when purchased.

The entity also assists the customers in resolving complaints about the meals and has a buyer satisfaction programme. However, the restaurant is responsible for fulfilling obligations associated with the voucher, including remedies to a customer for dissatisfaction with the service.

To determine whether the entity is a principal or an agent, the entity considers the nature of its promise and whether it takes control of the voucher (ie a right) before control transfers to the customer. In making this determination, the entity considers the indicators in paragraph B37 of IFRS 15 as follows:

(a) the entity is not responsible for providing the meals itself, which will be provided by the restaurants;

(b) the entity does not have inventory risk for the vouchers because they are not purchased before being sold to customers and the vouchers are non-refundable;

(c) the entity has some discretion in setting the sales prices for vouchers to customers, but the sales prices are jointly determined with the restaurants; and

(d) the entity’s consideration is in the form of a commission, because it is entitled to a stipulated percentage (30 per cent) of the voucher price.

The entity concludes that its promise is to arrange for goods or services to be provided to customers (the purchasers of the vouchers) in exchange for a commission. On the basis of the indicators in paragraph B37 of IFRS 15, the entity concludes that it does not control the vouchers that provide a right to meals before they are transferred to the customers. Thus, the entity concludes that it is an agent in the arrangement and recognises revenue in the net amount of consideration to which the entity will be entitled in exchange for the service, which is the 30 per cent commission it is entitled to upon the sale of each voucher.

Following the issuance of the standards, stakeholders raised several implementation questions regarding the principal versus agent application guidance related primarily to the control requirement and the indicators. Members of the TRG and the Boards discussed:
How the control principle interacts with the indicators that an entity is an agent

How the principal versus application guidance is intended to apply to intangible goods or services

These discussions led the IASB to propose clarifications to the principal versus agent application guidance and the illustrative examples in IFRS 15 in its July 2015 exposure draft. The proposals clarify that, an entity needs to:

- Identify the nature of the specified good or service to be provided to the customer (e.g., a right to goods or services or a bundle of goods or services)
  
  And

- Assess whether it controls that specified good or service before it is transferred to the customer, using the indicators to support this assessment when appropriate

These proposed clarifications are discussed further in Sections 4.4.1 and 4.4.2 below. The FASB proposed consistent clarifications to ASC 606 in August 2015.

Members of the TRG and the Boards also discussed whether certain amounts billed to customers (e.g., shipping and handling, reimbursement of out-of-pocket expenses, taxes or other assessments) should be presented as revenue or as a reduction of costs (i.e., on a gross or net basis). These discussions led the FASB, in September 2015, to propose an amendment to ASC 606 that would allow an entity to make an accounting policy election under US GAAP to present revenue net of certain types of taxes collected from a customer, including sales, use, value-added and some excise taxes. The IASB did not propose a similar amendment. This is discussed further in Section 5 below.

4.4.1 Identifying the specified good or service: applying the principal versus agent application guidance to intangible goods or services

Following the issuance of the standards, stakeholders raised concerns in relation to the principal versus agent application guidance because it is sometimes difficult to determine which party controls an intangible good or service prior to its transfer to the customer and it is not always clear which party is the customer. For example, an online game developer’s customer may be the intermediary that hosts the game on its network (or platform) or it may be the end-consumer.

Stakeholders indicated that some of the challenges may be linked to identifying the specified good or service. For example, Example 47 in IFRS 15 (see Section 4.4 above) illustrates a travel agent selling airline tickets to customers. Some questioned whether the principal versus agent assessment in that example is in respect of the flight or the ticket (which gives the right to fly).

The Boards subsequently considered this issue and agreed that appropriately identifying the specified good or service is important and will assist entities in determining whether they are the principal or agent in a transaction. Furthermore, the Boards agreed to propose amendments to the application guidance to explain the application of the control principle in relation to services (i.e., what would be controlled if an entity is the principal providing a service).

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72 Exposure draft ED/2015/6, Clarifications to IFRS 15 issued by the IASB in July 2015

73 FASB Proposed ASU, Revenue from Contracts with Customers – Principal versus Agent Considerations (Reporting Revenue Gross versus Net), August 2015
In its July 2015 exposure draft, the IASB proposed: 74

- Clarifying that the unit of account for the principal versus agent evaluation would be at the level of a specified good or service, which is a distinct good or service (or a distinct bundle of goods or services) - depending on the circumstances, a specified good or service may be a right to an underlying good or service to be provided by another party.

- Clarifying and explaining the application of the control principle in relation to services (i.e., what would be controlled if an entity is the principal providing a service)? 75

And

- Adding two examples and amending existing illustrative examples (i.e., Examples 45-48) that accompany IFRS 15 to align them with the amendments discussed above and those discussed in Section 4.4.2 below.

The FASB proposed consistent clarifications to ASC 606 in August 2015. 76

4.4.2 Interaction between the control principle and the indicators that an entity is an agent

Discussions at the July 2014 TRG meeting highlighted that stakeholders have questioned how the indicators that an entity is an agent interact with the requirement to consider whether the entity obtains control of a good or service before providing it to the end-customer. Some believe that control is the basis used to determine whether an entity is a principal or an agent and that the indicators complement this determination. Others believe that an entity first assesses whether it controls the goods or services before transfer. If it does not, only then does it consider the principal versus agent indicators to assess whether it is the principal in the transaction. Some have questioned whether the indicators should be weighted and how contradictory indicators should be considered.

The Boards subsequently considered this issue and agreed that the determining factor would be whether the entity controls the goods or services before transfer. If the entity obtains control before transfer, it is the principal, not an agent. In reaching this conclusion, the Boards considered the explanation in the Basis for Conclusions to the standards, which highlights that this is not a two-step process, but rather a single assessment based on control. 77

The Boards also noted that the indicators were included in the standards to help an entity assess whether it controls a good or service before transfer in situations where the assessment of control may be difficult. 78 That is, the indicators support the assessment; they are not intended to be considered in isolation or viewed as a checklist. Furthermore, they need not be considered in all scenarios. As such, an entity should not conclude that it is a principal based on an assessment of the indicators, only to determine that it does not control the goods or services before transfer. Rather, if such indicators are present, an entity likely already has control of a good or service before transfer. The Boards also agreed with their staffs that, while the indicators are similar to those currently included in IAS 18 and in US GAAP, they have a different purpose.

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74 Exposure draft ED/2015/6, *Clarifications to IFRS 15* issued by the IASB in July 2015

75 Exposure draft ED/2015/6, *Clarifications to IFRS 15*, paragraph BC35

76 FASB Proposed ASU, *Revenue from Contracts with Customers – Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, August 2015

77 IFRS 15.BC380

78 IFRS 15.BC382
Therefore, it is possible that conclusions about principal versus agent under the standards could be different from those reached today.

In light of these discussions, in its July 2015 exposure draft, the IASB proposed:

- Clarifying that the determining factor in the analysis would be whether the entity controls the specified good or service (see Section 4.4.2 above) before transfer to the customer — if the entity obtains control before transfer, it is the principal, not an agent;

- Clarifying that the indicators support the control assessment and are intended to help an entity assess whether it controls a good or service before transfer to a customer in situations in which the assessment of control may be difficult — they do not override the assessment of control and are not intended to be considered in isolation or viewed as a checklist;

- Reframing the indicators so that they would indicate when an entity is a principal, rather than when an entity is an agent;

And

- Adding two examples and amending existing illustrative examples (i.e., Examples 45-48) that accompany IFRS 15 to align them with the amendments discussed above and those discussed in Section 4.4.1 above.

The FASB proposed consistent clarifications to ASC 606 in August 2015.

4.5 Consignment arrangements

Entities frequently deliver inventory on a consignment basis to other parties (e.g., distributor, dealer). By shipping on a consignment basis, consignors are able to better market products by moving them closer to the end user. However, they do so without selling the goods to the intermediary (consignee).

The Boards provided the following indicators that an arrangement is a consignment arrangement:

**Extract from IFRS 15**

B78. Indicators that an arrangement is a consignment arrangement include, but are not limited to, the following:

a) the product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer or until a specified period expires;

b) the entity is able to require the return of the product or transfer the product to a third party (such as another dealer); and

c) the dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).

Entities entering into a consignment arrangement must determine the nature of the performance obligation (i.e., whether the obligation is to transfer the inventory to the consignee or to transfer the inventory to the end customer). This determination is based on whether control of the inventory has passed to the consignee upon delivery. Typically, a consignor will not relinquish control of consignment inventory until the inventory is sold to the end-consumer or, in

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79 Exposure draft ED/2015/6, Clarifications to IFRS 15
80 Exposure draft ED/2015/6, Clarifications to IFRS 15, paragraph BC35
81 FASB Proposed ASU, Revenue from Contracts with Customers – Principal versus Agent Considerations (Reporting Revenue Gross versus Net), August 2015
some cases, when a specified period expires. Consignees commonly do not have any obligation to pay for the inventory, other than to pay the consignor the agreed-upon portion of the sale price once the consignee sells the product to a third party. As a result, revenue generally would not be recognised for consignment arrangements when the goods are delivered to the consignee because control has not yet transferred (i.e., the performance obligation to deliver goods to the customer has not yet been satisfied).

4.6 Customer options for additional goods or services

Many sales contracts give customers the option to purchase additional goods or services. These additional goods and services may be priced at a discount or may even be free of charge. Options to acquire additional goods or services at a discount can come in many forms, including sales incentives, customer award credits (e.g., frequent flyer programmes), contract renewal options (e.g., waiver of certain fees, reduced future rates) or other discounts on future goods or services.

The standard states that when an entity grants a customer the option to acquire additional goods or services, that option is only a separate performance obligation if it provides a material right to the customer that the customer would not receive without entering into the contract (e.g., a discount that exceeds the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). Note that while the Boards did not provide any bright lines as to what constitutes a ‘material’ right, they indicated in the Basis for Conclusions that the purpose of this requirement is to identify and account for options that customers are essentially paying for (often implicitly) as part of the transaction.\footnote{IFRS 15.BC386}

If the discounted price in the option reflects the stand-alone selling price (separate from any existing relationship or contract), the entity is deemed to have made a marketing offer rather than having granted a material right. The standard states that this is the case even if the option can only be exercised because the customer entered into the earlier transaction. Assessing whether the entity has granted its customer a material right could require the exercise of significant judgement in some situations.

How we see it

Current IFRS does not provide application guidance on how to distinguish between an option and a marketing offer. Nor does it address how to account for options that provide a material right. As a result, some entities may have effectively accounted for such options as marketing offers. The new standard establishes requirements for accounting for options for additional goods or services. Careful assessment of contractual terms will be important to distinguish between options and marketing offers as this could impact the timing of revenue recognition for the portion of the transaction price allocated to an option. IFRS 15’s requirements on the amount of the transaction price to be allocated to the option differ significantly from current practice due to the lack of guidance in current IFRS (see Section 6.1.5).
The standard includes the following example to illustrate the determination whether an option represents a material right:

**Extract from IFRS 15**

Example 49 – Option that provides the customer with a material right (discount voucher) (IFRS 15.IE250–IE253)

An entity enters into a contract for the sale of Product A for CU100. As part of the contract, the entity gives the customer a 40 per cent discount voucher for any future purchases up to CU100 in the next 30 days. The entity intends to offer a 10 per cent discount on all sales during the next 30 days as part of a seasonal promotion. The 10 per cent discount cannot be used in addition to the 40 per cent discount voucher.

Because all customers will receive a 10 per cent discount on purchases during the next 30 days, the only discount that provides the customer with a material right is the discount that is incremental to that 10 per cent (i.e., the additional 30 per cent discount). The entity accounts for the promise to provide the incremental discount as a performance obligation in the contract for the sale of Product A.

To estimate the stand-alone selling price of the discount voucher in accordance with paragraph B42 of IFRS 15, the entity estimates an 80 per cent likelihood that a customer will redeem the voucher and that a customer will, on average, purchase CU50 of additional products. Consequently, the entity’s estimated stand-alone selling price of the discount voucher is CU12 (CU50 average purchase price of additional products × 30 per cent incremental discount × 80 per cent likelihood of exercising the option). The stand-alone selling prices of Product A and the discount voucher and the resulting allocation of the CU100 transaction price are as follows:

<table>
<thead>
<tr>
<th>Performance obligations</th>
<th>Stand-alone selling price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>CU 100</td>
</tr>
<tr>
<td>Discount voucher</td>
<td>CU 12</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>CU 112</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Allocated transaction price</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>(CU100 ÷ CU112 × CU100)</td>
</tr>
<tr>
<td>Discount voucher</td>
<td>(CU12 ÷ CU112 × CU100)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>CU 100</strong></td>
</tr>
</tbody>
</table>

The entity allocates CU89 to Product A and recognises revenue for Product A when control transfers. The entity allocates CU11 to the discount voucher and recognises revenue for the voucher when the customer redeems it for goods or services or when it expires.
Summary of recent TRG discussions

Considerations when assessing customer options for additional goods or services

Following the issuance of the standard, members of the TRG discussed a number of issues that could affect the assessment of customer options. The following issues were discussed at the October 2014 TRG meeting.

Firstly, when determining whether an option for additional goods and services provides the customer with a material right, members of the TRG discussed whether entities should consider only the current transaction or also past and future transactions with the same customer. 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.

Secondly, members of the TRG considered whether the material right evaluation is solely a quantitative evaluation or whether it should also consider qualitative factors. 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, whether the average customer life indicates that the fee provides an incentive for customers to remain beyond the stated contract term).

Accounting for the exercise of a material right

At the March 2015 TRG meeting, members of the TRG were asked to consider how an entity would account for the exercise of an option for additional goods and services that provides the customer with a material right (a material right). Three potential views were put forward for TRG members to consider:

- A continuation of the existing contract - the current contract considers the additional goods or services for which a customer has a material right. Therefore, an entity would account for the exercise as a change in the transaction price of a contract (see Section 6.5 below).

  Under this view, at the time a customer exercises the option, an entity would: (a) update the transaction price to include any additional consideration to which the entity expects to be entitled as a result of the exercise; (b) allocate that additional consideration to the performance obligation underlying the material right; and (c) recognise the related revenue when (or as) the related performance obligation is satisfied.

- A contract modification - when a customer exercises a material right, the additional consideration received and/or the additional goods or services provided represent a change in the scope and/or price of a contract. Therefore, under this view, an entity would apply the requirements for contract modifications (see Section 3.3 above).

- Variable consideration - any potential additional consideration related to the exercise of a material right is variable consideration. Therefore, under this view, the additional consideration would be accounted for in accordance with the requirements for variable consideration (see Section 5.1 below)
**Summary of recent TRG discussions (cont’d)**

Some TRG members thought 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 generally 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.

4.7 Sale of products with a right of return

An entity may provide its customers with a right to return a transferred product. A right of return may be contractual, an implicit right that exists due to the entity’s customary business practice or a combination of both (e.g., an entity has a stated return period, but generally accepts returns over a longer period). A customer exercising its right to return a product may receive a full or partial refund, a credit applied to amounts owed, a different product in exchange or any combination of these items.

Offering a right of return in a sales agreement obliges the selling entity to stand ready to accept any returned product. However, the Boards decided that such an obligation does not represent a separate performance obligation. Instead, the Boards concluded that an entity makes an uncertain number of sales when it provides goods with a return right. That is, until the right of return expires, the entity is not certain how many sales will fail. Therefore, the Boards concluded that an entity does not recognise revenue for sales that are expected to fail as a result of the customer exercising its right to return the goods. Instead, the potential for customer returns needs to be considered when an entity estimates the transaction price because potential returns are a component of variable consideration. This concept is discussed further in Section 5.2.2.

The Boards pointed out that exchanges by customers of one product for another of the same type, quality, condition and price (e.g., one colour or size for another) are not considered returns for the purposes of applying the standard. Furthermore, contracts in which a customer may return a defective product in exchange for a functioning product need to be evaluated in accordance with the requirements on warranties included in IFRS 15. See further discussion on warranties in Section 8.1.
What’s changing from current IFRS?

Under current IFRS, revenue is recognised at the time of sale for a transaction that provides a customer with a right of return, provided the seller can reliably estimate future returns. In addition, the seller is required to recognise a liability for the expected returns. The new standard’s requirements are, therefore, not significantly different from current IFRS.

We do not expect the net impact of these arrangements to change materially. However, there may be some differences as IAS 18 does not specify the presentation of a refund liability and the corresponding debit. The new standard requires the return asset to be recognised in relation to the inventory that may be returned. In addition, the refund liability is required to be presented separately from the corresponding asset (i.e., on a gross basis, rather than a net basis, see Section 5.2.2).

\[83\] IAS 18.17
5 Determine the transaction price

The standard provides the following requirements for determining the transaction price:

**Extract from IFRS 15**

47. An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

48. The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. When determining the transaction price, an entity shall consider the effects of all of the following:

   (a) variable consideration (see paragraphs 50–55 and 59);
   (b) constraining estimates of variable consideration (see paragraphs 56–58);
   (c) the existence of a significant financing component in the contract (see paragraphs 60–65);
   (d) non-cash consideration (see paragraphs 66–69); and
   (e) consideration payable to a customer (see paragraphs 70–72).

49. For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed or modified.

The basis for the new requirements for determining the transaction price is the amount to which the entity expects to be entitled. This amount is meant to reflect the amount to which the entity has rights under the present contract. That is, the transaction price does not include estimates of consideration resulting from future change orders for additional goods and services. The amount to which the entity is entitled also excludes amounts collected on behalf of another party, such as sales taxes.

Following the issuance of the standards, some stakeholders informed the Boards’ staff that there could be multiple interpretations about whether certain items that are billed to customers should be presented as revenue or as a reduction of costs. Examples of such amounts include shipping and handling fees, reimbursements of out-of-pocket expenses and taxes or other assessments collected and remitted to government authorities.

At the July 2014 TRG meeting, members of the TRG generally agreed that the standards are clear that any amounts that are not collected on behalf of third parties would be included in the transaction price (i.e., revenue). That is, if the amounts were 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. In addition, TRG members indicated that an entity would apply the principal versus agent application guidance (see Section 4.4 above) when it is not clear whether the amounts are collected on behalf of third parties. This could result in amounts billed to a customer being recorded net of costs incurred (i.e., on a net basis).

To address this concern, in September 2015, the FASB proposed allowing an entity to make an accounting policy election to present revenue net of certain types of taxes, including sales, use, excise, value-added and some excise taxes (collectively referred to as sales taxes) with a requirement for preparers to disclose the policy. The IASB decided that such an expedient is not necessary in IFRS 15 as the topic was not an interpretative question and the requirements of IFRS 15 are consistent with current IFRS requirements.

In many cases, the transaction price can be readily determined because the entity receives payment when it transfers promised goods or services and the price is fixed (e.g., the sale of goods in a retail store). In other situations, determining the transaction price is more challenging when it is variable, when payment is received at a different time from when the entity provides goods or services, or when payment is in a form other than cash. Consideration paid or payable by the vendor to the customer also may affect the determination of the transaction price.

Determining the transaction price is an important step in the model because this amount is allocated to the identified performance obligations and is recognised as revenue as those performance obligations are satisfied.

5.1 Variable consideration
The transaction price reflects an entity’s expectations about the consideration to which it will be entitled from the customer. The standard provides the following requirements for determining whether consideration is variable and, if so, how it would be treated:

### Extract from IFRS 15

50. If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

51. An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. The promised consideration can also vary if an entity’s entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.
52. The variability relating to the consideration promised by a customer may be explicitly stated in the contract. In addition to the terms of the contract, the promised consideration is variable if either of the following circumstances exists:

(a) the customer has a valid expectation arising from an entity’s customary business practices, published policies or specific statements that the entity will accept an amount of consideration that is less than the price stated in the contract. That is, it is expected that the entity will offer a price concession. Depending on the jurisdiction, industry or customer this offer may be referred to as a discount, rebate, refund or credit.

(b) other facts and circumstances indicate that the entity’s intention, when entering into the contract with the customer, is to offer a price concession to the customer.

53. An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

(a) The expected value—the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.

(b) The most likely amount—the most likely amount is the single most likely amount in a range of possible consideration amounts (i.e. the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

54. An entity shall apply one method consistently throughout the contract when estimating the effect of an uncertainty on an amount of variable consideration to which the entity will be entitled. In addition, an entity shall consider all the information (historical, current and forecast) that is reasonably available to the entity and shall identify a reasonable number of possible consideration amounts. The information that an entity uses to estimate the amount of variable consideration would typically be similar to the information that the entity’s management uses during the bid-and-proposal process and in establishing prices for promised goods or services.

These concepts are discussed in more detail below.

5.1.1 Forms of variable consideration

As indicated in IFRS 15.51, ‘variable consideration’ has a broad definition. Since the constraint on variable consideration (as discussed further in Section 5.1.3) needs to be considered for each type of variable consideration, it is important for entities to appropriately identify the different types of variable consideration within its contracts.
Many types of variable consideration identified in IFRS 15 are treated similarly under current IFRS. An example of this is where a portion of the transaction price depends on an entity meeting specified performance conditions and there is uncertainty about the outcome. This portion of the transaction price would be considered variable consideration under both current IFRS and IFRS 15.

However, certain amounts that are considered variable consideration under IFRS 15 may be considered 'fixed' today. For example, IFRS 15's definition of variable consideration includes variability due to customer refunds or returns. As a result, a contract to provide a customer with 100 widgets at a fixed price per widget would include a variable component if the customer has the ability to return the widgets (see Section 5.2.2).

For some contracts, the stated pricing clearly has variable components. However, for other contracts, the consideration may be variable because the facts and circumstances indicate that the entity may accept a lower price than that stated in the contract. This could be as a result of the customer's valid expectation that the entity will reduce its price because of the entity's customary business practices, published policies or specific statements made to the customer. This potential price reduction could also exist because the particular facts and circumstances indicate that the entity intends to offer a price concession to the customer.

IFRS 15 suggests that if an entity is aware of potential collectability issues at the onset of the contract, but is still willing to enter into the contract, it may include implied price concessions. Such implied price concessions are considered to be variable consideration under IFRS 15. However, as discussed in Section 3.1.5, an entity in this situation also needs to determine whether it has entered into a valid contract with a customer. If, at contract inception, an entity determines that it is not probable that it will collect the estimated transaction price from the customer (note that the estimated transaction price may be lower than the stated contract price), it cannot conclude that the contract is valid and the model in the standard applies (see Section 3.4). When assessing step one of the model (i.e., to identify the contract), an entity is also required to consider step three of the model (i.e., to determine the transaction price).

When determining the transaction price, IFRS 15 requires an entity to determine whether credit risk (that was known at contract inception) represents an implied price concession (i.e., a form of variable consideration). If it is an implied price concession, it is not included in the estimated transaction price. Under current IFRS, such amounts are likely expensed as bad debts, rather than being reflected as a reduction of revenue.

However, in the Basis for Conclusions, the Boards acknowledged that in some cases, it may be difficult to determine whether the entity has implicitly offered a price concession or whether the entity has chosen to accept the risk of the customer defaulting on the contractually agreed consideration. The Boards did not develop detailed application guidance to assist in distinguishing between price concessions and impairment losses. Therefore, entities will need to consider all relevant facts and circumstances when analysing the nature of collectability issues that were known at contract inception.

\[\text{IFRS 15.BC194}\]
How we see it

Entities may find it challenging to distinguish between implied price concessions (i.e., reductions of revenue) and customer credit risk (i.e., a bad debt expense) for collectability issues that were known at contract inception. Entities will need to carefully evaluate all facts and circumstances that were available at contract inception, as well as any subsequent events, that may have affected the customer’s ability to pay. Significant judgement will be required when making this determination. Entities should develop clear policies and procedures for these evaluations to ensure consistent application across all transactions.

Variable consideration may also result from extended payment terms in a contract (and any resulting uncertainty about the entity’s ability to collect those amounts in the future). That is, an entity must evaluate whether the extended payment terms represent an implied price concession if the entity does not intend to, or will not be able to, collect all amounts due in future periods.

Summary of recent TRG discussions

<table>
<thead>
<tr>
<th>Identifying variable consideration: undefined quantities with fixed per unit contractual prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>At the July 2015 TRG meeting, members of the TRG were asked whether the consideration is variable in a contract that includes a promise to provide an undefined quantity of outputs or to perform an undefined quantity of tasks, but has a fixed contractual rate per unit. 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.</td>
</tr>
<tr>
<td>The agenda paper&lt;sup&gt;85&lt;/sup&gt; on this topic noted that an entity would need to consider contractual minimums (or other clauses) that would make some or all of the consideration fixed.</td>
</tr>
</tbody>
</table>

5.1.2 Estimating variable consideration

An entity is required to estimate the transaction price using either the ‘expected value’ or the ‘most likely amount’ approach. An entity is required to make that decision based on the approach that better predicts the amount of consideration to which it will be entitled. That is, the method selected is not meant to be a ‘free choice’. Rather, an entity selects the method that is best suited, based on the facts and circumstances.

An entity applies the selected method consistently throughout the contract and updates the estimated transaction price at the end of each reporting period. Once it selects an approach, an entity is required to apply that approach consistently to similar types of contracts. In the Basis for Conclusions, the Boards noted that a contract may contain different types of variable consideration.<sup>86</sup> As such, it may be appropriate for an entity to use different

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<sup>86</sup> IFRS 15.BC202
approaches (i.e., expected value or most likely amount) for estimating different types of variable consideration within a single contract.

Under the expected value approach, the entity identifies the possible outcomes of a contract and the probabilities of those outcomes. The Boards indicated that the expected value approach may better predict expected consideration when an entity has a large number of contracts with similar characteristics. The Boards also clarified that an entity preparing an expected value calculation is not required to consider all possible outcomes, even if the entity has extensive data and can identify many possible outcomes. Instead, the Boards indicated in the Basis for Conclusions that, in many cases, a limited number of discrete outcomes and probabilities can provide a reasonable estimate of the expected value.³⁷

The Boards indicated that the most likely amount approach may be the better predictor when the entity expects to be entitled to one of two possible amounts. For example, a contract in which an entity is entitled to receive all or none of a specified performance bonus, but not a portion of that bonus.

The standard states that when applying either of these approaches, an entity considers all information (historical, current and forecast) that is reasonably available to the entity. While not explicitly stated, the standard implies that an entity will always have the ability to estimate the amount of variable consideration to which it will be entitled, except for sales-based royalties (see Section 5.2.1).

Once an estimate of variable consideration has been made, the constraint on variable consideration must be applied to that estimate (see Section 5.1.3).

How we see it

Many entities will see significant changes in how they account for variable consideration. This will be an even more significant change for entities that currently do not attempt to estimate variable consideration and simply recognise such amounts when received or the uncertainty is resolved. We anticipate implementation questions will continue to be raised on the determination of variable consideration.

Summary of recent TRG discussions

*Expected value method: portfolio approach versus considering evidence from other similar contracts to develop an estimate*

At the July 2015 TRG meeting, members of the TRG were asked to consider whether an entity is applying the portfolio approach (see Section 3.2 above) when it considers evidence from other similar contracts to develop an estimate of variable consideration using an expected value method. This question was raised, in part, because the portfolio approach can only be applied if the entity reasonably expects that the difference between applying IFRS 15 to a portfolio of contracts and applying it to an individual contract would not result in a material effect on the financial statements.

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 apply the portfolio approach, but is not required to do so.
5.1.3 Constraining the cumulative amount of revenue recognised

After estimating the amount of variable consideration within the transaction price, the entity must apply the constraint on variable consideration. The Boards created this constraint to address concerns raised by many constituents about the possible recognition of revenue before there was sufficient certainty that the amounts would ultimately be realised.

As the following extract from the standard states, the constraint is aimed at preventing the over-recognition of revenue (i.e., the focus is on potential significant reversals of revenue).

**Extract from IFRS 15**

56. An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

57. In assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:

(a) the amount of consideration is highly susceptible to factors outside the entity’s influence. Those factors may include volatility in a market, the judgement or actions of third parties, weather conditions and a high risk of obsolescence of the promised good or service.

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

(c) the entity’s experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value.

(d) the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.

(e) the contract has a large number and broad range of possible consideration amounts.

58. An entity shall apply paragraph B63 to account for consideration in the form of a sales-based or usage-based royalty that is promised in exchange for a licence of intellectual property.

To include variable consideration in the estimated transaction price, the entity has to conclude that it is ‘highly probable’ that a significant revenue reversal will not occur in future periods. That is, the constraint considers both the likelihood and magnitude of a revenue reversal. Furthermore, the constraint is based on the possibility of a reversal of an amount that is ‘significant’ relative to cumulative revenue recognised in the contract (see the discussion further below). The significance assessment of the potential revenue reversal will need to contemplate the contract’s total transaction price (not only the amount of variable consideration in the contract or the transaction price allocated to the performance obligation).
For purposes of this analysis, the meaning of the term ‘highly probable’ is consistent with the existing definition in IFRS, i.e., “significantly more likely than probable”.88 Note, for US GAAP preparers, the standard uses the term ‘probable’ rather than ‘highly probable’, which is defined as “the future event or events are likely to occur”.89 However, the meaning of ‘probable’ under US GAAP is intended to be the same as ‘highly probable’ under IFRS.90

As noted above, the constraint considers both the likelihood and magnitude of a revenue reversal:

- **Likelihood** – assessing the likelihood of future revenue reversal will require significant judgement. Entities will want to ensure they adequately document the basis for their conclusions. The presence of any one of the indicators cited in the extract above does not necessarily mean that it is highly probable that a change in the estimate of variable consideration will result in a significant revenue reversal. The Boards chose to provide indicators rather than criteria to signal that the list of items to consider is not a checklist for which all items need to be met. In addition, the indicators provided are not meant to be an all-inclusive list and entities may note additional factors that are relevant in their evaluations.

- **Magnitude** – when assessing the probability of a significant revenue reversal, an entity also is required to assess the magnitude of that reversal relative to the total consideration in the arrangement (i.e., the total of variable and fixed consideration). For example, if the consideration for a single performance obligation includes both a fixed and a variable amount, the entity would assess the magnitude of a possible revenue reversal of the variable amount relative to the total consideration.

The standard includes one exception to the measurement principles for variable consideration for sales or usage-based royalties associated with a licence of intellectual property. Such amounts are not included in the transaction price or recognised as revenue until the subsequent sale or usage occurs (see Sections 5.2.1 and 8.4.4). In addition, the standard provides an example of an asset management agreement that includes an incentive fee, which is based on the return on the fund compared to the return on an observable market index over a five-year period. The example illustrates that the entity is not able to conclude that it is highly probable that a significant revenue reversal will not occur if the incentive fee is included in the transaction price.

There are other types of variable consideration that are frequently included in contracts that have significant uncertainties. It will be difficult for an entity to assert it is highly probable that these types of estimated amounts will not be subsequently reversed. Such types of variable consideration include the following:

- Payments contingent on regulatory approval (e.g., regulatory approval of a new drug)
- Long-term commodity supply arrangements that settle based on market prices at the future delivery date
- Contingency fees based on litigation or regulatory outcomes (e.g., fees based on the positive outcome of litigation or the settlement of claims with government agencies)

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88 As defined in IFRS 5 Appendix A.
89 See footnote 30 in this publication
90 IFRS15.BC211
When an entity determines that it is highly probable that a change in the estimate of variable consideration would result in a significant revenue reversal, the amount of variable consideration that must be included in the transaction price is limited to the amount that would not result in a significant revenue reversal. That is, an entity is required to include the amount of variable consideration in the transaction price that will not result in a significant revenue reversal when the uncertainty associated with the variable consideration is subsequently resolved.

The Boards noted, in the Basis for Conclusions, that an entity is not required to strictly follow a two-step process (i.e., first estimate the variable consideration and then apply the constraint to that estimate) if its internal processes incorporate the principles of both steps in a single step. For example, if an entity already has a single process to estimate expected returns when calculating revenue from the sale of goods in a manner consistent with the objectives of applying the constraint, the entity would not need to estimate revenue and then separately apply the constraint.

When a contract includes variable consideration, an entity updates its estimate of the transaction price throughout the term of the contract to depict conditions that exist at the end of each reporting period. This will involve updating both the estimate of the variable consideration and the constraint on the amount of variable consideration included in the transaction price.

The following provides an illustration of the two methods for estimating the variable consideration and the effect of the constraint on both:

**Illustration 5-1 — Estimating variable consideration**

**Scenario A**

Entity A provides transportation to theme park customers to and from accommodation in the area under a one-year agreement. It is required to provide scheduled transportation throughout the year for a fixed fee of CU400,000 annually. Entity A also is entitled to performance bonuses for on-time performance and average customer wait times. Its performance may yield a bonus from CU0 to CU600,000 under the contract. Based on its history with the theme park, customer travel patterns and its current expectations, Entity A estimates the probabilities for different amounts of bonus within the range as follows:

<table>
<thead>
<tr>
<th>Bonus amount</th>
<th>Probability of outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>30%</td>
</tr>
<tr>
<td>CU200,000</td>
<td>30%</td>
</tr>
<tr>
<td>CU400,000</td>
<td>35%</td>
</tr>
<tr>
<td>CU600,000</td>
<td>5%</td>
</tr>
</tbody>
</table>

**Analysis**

*Expected value*

Because Entity A believes that there is no one amount within the range that is most likely to be received, Entity A determines that the expected value approach is most appropriate. As a result, Entity A estimates variable consideration to be CU230,000 ((CU200,000 x 30%) + (CU 400,000 x 35%) + (CU 600,000 x 5%)) before considering the effect of the constraint.

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91 IFRS 15.BC215
Illustration 5-1 — Estimating variable consideration (cont’d)

Assume that Entity A is a calendar year-end entity and it entered into the contract with the theme park during its second quarter. Customer wait times were slightly above average during the second quarter. Based on this experience, Entity A determines that it is highly probable that a significant revenue reversal for CU200,000 of variable consideration will not occur. Therefore, after applying the constraint, Entity A only includes CU200,000 in its estimated transaction price. At the end of its third quarter, Entity A updates its analysis and expected value calculation. The updated analysis again results in estimated variable consideration of CU230,000, with a probability outcome of 75%. Based on analysis of the factors in IFRS 15.57 and in light of slightly better-than-expected average customer wait times during the third quarter, Entity A determines that it is highly probable that a significant revenue reversal for the entire CU230,000 estimated transaction price would not be subject to a significant revenue reversal. Entity A updates its estimate to include the entire CU230,000 in the transaction price. Entity A will continue to update its estimate of the transaction price at each subsequent reporting period.

Scenario B

Assume the same facts as in Scenario A, except that the potential bonus will be one of four stated amounts: CU0, CU200,000, CU400,000 or CU600,000. Based on its history with the theme park and customer travel patterns, Entity A estimates the probabilities for each bonus amount as follows:

<table>
<thead>
<tr>
<th>Bonus amount</th>
<th>Probability of outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>-</td>
<td>30%</td>
</tr>
<tr>
<td>CU200,000</td>
<td>30%</td>
</tr>
<tr>
<td>CU400,000</td>
<td>35%</td>
</tr>
<tr>
<td>CU600,000</td>
<td>5%</td>
</tr>
</tbody>
</table>

Analysis

Expected value

Entity A determined that the expected value approach was the most appropriate to use when estimating its variable consideration. Under that approach, it estimates the variable consideration is CU230,000. Entity A must then consider the effect of the constraint on the amount of variable consideration included in the transaction price.

Entity A notes that, because there are only four potential outcomes under the contract, the constraint essentially limits the amount of revenue Entity A can recognise to one of the stated bonus amounts. In this example, Entity A would be limited to including CU200,000 in the estimated transaction price until it became highly probable that the next bonus level (i.e., CU400,000) was achieved. This is because any amount over CU200,000 would be subject to subsequent reversal, unless CU400,000 was received.

Most likely amount

As there are only a limited number of outcomes for the amount of bonus that can be received, Entity A is concerned that a probability-weighted estimate may result in an amount that is not a potential outcome. Therefore, Entity A determines that estimating the transaction price by identifying the most likely outcome would be the best predictor.
Illustration 5-1 – Estimating variable consideration (cont’d)

The standard is not clear about how an entity would determine the most likely amount when there are more than two potential outcomes and none of the potential outcomes is significantly more likely than the others. A literal reading of the standard might suggest that, in this example, Entity A would select CU400,000 because that is the amount with the highest estimated probability. However, Entity A must then apply a constraint on the amount of variable consideration included in the transaction price.

To include CU400,000 in the estimated transaction price, Entity A has to believe it is highly probable that the bonus amount will be at least CU400,000. Based on the listed probabilities above, however, Entity A believes it is only 40% (i.e., 35% + 5%) likely to receive a bonus of at least CU400,000 and 70% (i.e., 30% + 35% + 5%) likely it will receive a bonus of at least CU200,000. As a result, Entity A would include only CU200,000 in its estimate of the transaction price.

Note: At the July 2015 TRG meeting, members of the TRG discussed a similar example, but with the added assumption that the entity had a large number of similar contracts with similar characteristics. Our above example is for an individual, unique contract. For further information, see the summary of TRG discussions below.

How we see it

We anticipate that the application of the constraint, including determining when it is highly probable that a significant revenue reversal would not occur, may raise issues in practice. Over time, best practices, and possibly application guidance, are likely to emerge for how entities consider the constraint on variable consideration when estimating the transaction price.

What’s changing from current IFRS?

For a number of entities, the treatment of variable consideration under the new standard could represent a significant change from current practice.

Under current IFRS, preparers often defer measurement of variable consideration until revenue is reliably measurable, which could be when the uncertainty is removed or when payment is received.

Furthermore, current IFRS permits recognition of contingent consideration, but only if it is probable that the economic benefits associated with the transaction will flow to the entity and the amount of revenue can be reliably measured. Some entities, therefore, defer recognition until the contingency is resolved. Some entities have looked to US GAAP to develop their accounting policies in this area. Currently, US GAAP significantly limits recognition of contingent consideration, although certain industries have industry-specific literature that allows for recognition of contingent amounts.

In contrast, the constraint on variable consideration in the new standard is an entirely new way of evaluating variable consideration and is applicable to all types of variable consideration in all transactions. As a result, depending on the

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92 IAS 18.14, IAS 18.18 and IAS 11.11.
93 As discussed in ASC 605-25 and SEC Staff Accounting Bulletin Topic 13: Revenue Recognition.
94 Refer to ASC 605-20, Revenue Recognition – Services, specifically paragraph 605-20-S99-1.
requirements entities were previously applying, some entities may recognise revenue sooner under the new standard, while others may recognise revenue later.

IFRS 15 cites the following example of revenue recognition for performance-based incentive fees in investment management contracts that are subject to the constraint. For some entities, the treatment of performance-based incentive fees under IFRS 15 will be consistent with current practice. However, in some cases, revenue may be recognised later than under current practice.

Extract from IFRS 15

Example 25 – Management fees subject to the constraint (IFRS 15.IE129-IE133)

On 1 January 20X8, an entity enters into a contract with a client to provide asset management services for five years. The entity receives a two per cent quarterly management fee based on the client’s assets under management at the end of each quarter. In addition, the entity receives a performance-based incentive fee of 20 per cent of the fund’s return in excess of the return of an observable market index over the five-year period. Consequently, both the management fee and the performance fee in the contract are variable consideration.

The entity accounts for the services as a single performance obligation in accordance with paragraph 22(b) of IFRS 15, because it is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress—that is, a time-based measure of progress).

At contract inception, the entity considers the requirements in paragraphs 50–54 of IFRS 15 on estimating variable consideration and the requirements in paragraphs 56–58 of IFRS 15 on constraining estimates of variable consideration, including the factors in paragraph 57 of IFRS 15. The entity observes that the promised consideration is dependent on the market and thus is highly susceptible to factors outside the entity’s influence. In addition, the incentive fee has a large number and a broad range of possible consideration amounts. The entity also observes that although it has experience with similar contracts, that experience is of little predictive value in determining the future performance of the market. Therefore, at contract inception, the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognised would not occur if the entity included its estimate of the management fee or the incentive fee in the transaction price.

At each reporting date, the entity updates its estimate of the transaction price. Consequently, at the end of each quarter, the entity concludes that it can include in the transaction price the actual amount of the quarterly management fee because the uncertainty is resolved. However, the entity concludes that it cannot include its estimate of the incentive fee in the transaction price at those dates. This is because there has not been a change in its assessment from contract inception – the variability of the fee based on the market index indicates that the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognised would not occur if the entity included its estimate of the incentive fee in the transaction price. At 31 March 20X8, the client’s assets under management are CU100 million. Therefore, the resulting quarterly management fee and the transaction price is CU2 million.
At the end of each quarter, the entity allocates the quarterly management fee to the distinct services provided during the quarter in accordance with paragraphs 84(b) and 85 of IFRS 15. This is because the fee relates specifically to the entity’s efforts to transfer the services for that quarter, which are distinct from the services provided in other quarters, and the resulting allocation will be consistent with the allocation objective in paragraph 73 of IFRS 15. Consequently, the entity recognises CU2 million as revenue for the quarter ended 31 March 20X8.

IFRS 15 may change practice for many entities that sell their products through distributors or resellers. Before revenue can be recognised, IAS 18.14 requires that the amount of revenue can be measured reliably and that it be probable that the economic benefits associated with the transaction will flow to the entity. As a result, when the sales price charged to the distributor or reseller is not finalised until the product is sold to the end-customer, entities may wait until the product is sold to the end-customer to recognise revenue.

Under IFRS 15, waiting until the end-sale has occurred will no longer be acceptable if the only uncertainty is the variability in the pricing. This is because IFRS 15 requires an entity to estimate the variable consideration based on the information available, taking into consideration the effect of the constraint on variable consideration. However, in some cases, the outcomes under the new and current methods may be similar.

Summary of recent TRG discussions

Applying the constraint on variable consideration: contract level versus performance obligation level

At the January 2015 TRG meeting, members of the TRG were asked whether an entity was required to apply the constraint on variable consideration at the contract level or at the performance obligation level.

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).

Applying the constraint on variable consideration: considering possible outcomes of the contract

At the July 2015 TRG meeting, members of the TRG discussed whether the estimated transaction price must be a possible outcome of an individual contract. They had different ideas about when the transaction price would have to be constrained to the highest amount that is both a possible and a highly probable outcome of the contract.

In the Basis for Conclusions, the Boards indicated that an expected value method may better predict the expected consideration when an entity has a large number of contracts with similar characteristics. However, using this method for a contract with several discrete outcomes may result in an estimated transaction price that is not a possible outcome of an individual contract. TRG members discussed an example in which Entity A develops websites for its customers. Its contract terms all involve a fixed fee plus

95 IFRS 15.BC200
Summary of recent TRG discussions (cont’d)

variable consideration in the form of a performance bonus for completing each website by a specified date. Based on Entity A’s experience, the bonus amounts and probabilities for achieving them are, as follows:

<table>
<thead>
<tr>
<th>Bonus amount</th>
<th>Probability of occurrence</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>15%</td>
</tr>
<tr>
<td>CU50,000</td>
<td>40%</td>
</tr>
<tr>
<td>CU100,000</td>
<td>45%</td>
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</tbody>
</table>

Assume that Entity A concludes that the expected value method would better predict the amount of consideration to which it will be entitled because it has a large number of contracts that have similar characteristics. The expected value of the variable consideration would, therefore, be CU65,000 (CU0 * 15% + CU50,000 * 40% + CU100,000 * 45%).

Some TRG members said that, when evaluating an individual contract, the variable consideration would be constrained to CU50,000 because CU65,000 is not a possible outcome of the contract. That is, they believe that a reversal of CU15,000 is highly probable because there is only a 45% chance that the entity will earn the CU100,000 bonus. Other TRG members observed that the entity would record CU65,000 if the entity has a large group of similar contracts in the reporting period because it would expect (on the basis of the population of the similar contracts) to be entitled to an average of CU65,000 per contract.

At the meeting, the Boards’ staff indicated they would summarise TRG members’ discussions and try to address the questions raised by TRG members, possibly through examples or a decision framework. The TRG may possibly discuss this issue again at its next meeting in November 2015.

5.2 Accounting for specific types of variable consideration

5.2.1 Sales and usage-based royalties from the licence of intellectual property

The Boards provided explicit requirements for recognising sales and usage-based royalties from licences of intellectual property. Specifically, rather than follow the requirements described above for estimating variable consideration, IFRS 15 includes an exception for transactions that involve sales and usage-based royalties that result from the licence of intellectual property. For those transactions, the standard states that an entity only includes such consideration in the transaction price when the subsequent sale or usage occurs. See Section 8.4 for a detailed discussion on licences of intellectual property.

In February 2015, the Boards agreed to proposed amendments to clarify that the sales or usage-based royalty exception would be applied to the overall royalty stream when the predominant item to which the royalty relates is the licence of intellectual property. Furthermore, the proposed amendments would clarify that a sales or usage-based royalty in these types of arrangements would not be partially in the scope of the sales or usage-based royalty exception and partially in the scope of the general variable consideration constraint requirements. The IASB issued an exposure draft in July 2015 proposing this
amendment.\textsuperscript{96} The FASB’s proposed changes were exposed for public comment in May 2015.\textsuperscript{97} See Section 8.4.4 below for further discussion.

5.2.2 Rights of return

As discussed in Section 4.7, the standard states that a right of return does not represent a separate performance obligation. Instead, a right of return affects the transaction price and the amount of revenue an entity can recognise for satisfied performance obligations. In other words, rights of return create variability in the transaction price.

While IFRS 15’s accounting treatment for rights of return may not significantly change current practice, there are some notable differences. Under IFRS 15, an entity will estimate the transaction price and apply the constraint to the estimated transaction price. In doing so, it will consider the products expected to be returned in order to determine the amount to which the entity expects to be entitled (excluding the products expected to be returned).

It is unclear whether this requirement will result in a significant adjustment to an entity’s returns estimated under current requirements. Consistent with IAS 18.17, an entity will recognise the amount of expected returns as a refund liability, representing its obligation to return the customer’s consideration. If the entity estimates returns and applies the constraint, the portion of the revenue subject to the constraint would not be recognised until the amounts are no longer subject to the constraint, which could be at the end of the return period.

As part of updating its estimate of amounts it expects to be entitled to under an arrangement, an entity must update its assessment of expected returns and the related refund liabilities. This remeasurement is performed at the end of each reporting period and reflects any changes in assumptions about expected returns. Any adjustments made to the estimate will result in a corresponding adjustment to amounts recognised as revenue for the satisfied performance obligations (e.g., if the entity expects the number of returns to be lower than originally estimated, it would have to increase the amount of revenue recognised and decrease the refund liability).

Finally, when customers exercise their rights of return, the entity may receive the returned product in saleable or repairable condition. Under the standard, at the time of the initial sale (i.e., when recognition of revenue is deferred due to the anticipated return), the entity recognises a return asset (and adjusts the cost of goods sold) for its right to recover the goods returned by the customer. The entity initially measures this asset at the former carrying amount of the inventory, less any expected costs to recover the goods. Along with remeasuring the refund liability at the end of each reporting period, the entity updates the measurement of the asset recorded for any revisions to its expected level of returns, as well as any potential decreases in the value of the returned products. That is, a returned item is recognised at the lower of the original cost less the cost to recover the asset or the fair value of the asset at the time of recovery.

The classification in the statement of financial position for amounts related to the right of return asset may be a change from current practice. Under current IFRS, an entity typically recognises a liability and corresponding expense, but may not recognise a return asset for the inventory that may be returned, as is required by the new standard. In addition, IFRS 15 is clear that the carrying

\textsuperscript{96} Exposure draft ED/2015/6, \textit{Clarifications to IFRS 15} issued by the IASB in July 2015

\textsuperscript{97} FASB Proposed ASU, \textit{Revenue from Contracts with Customers – Identifying Performance Obligations and Licensing}, May 2015
value of the return asset (i.e., the product expected to be returned) is subject to
impairment testing on its own, separately from inventory on hand. IFRS 15 also
requires the refund liability to be presented separately from the corresponding
asset (on a gross basis rather than a net basis).

Extract from IFRS 15

Example 22 – Right of return (IFRS 15.IE110-IE115)

An entity enters into 100 contracts with customers. Each contract includes the
sale of one product for CU100 (100 total products × CU100 = CU10,000 total
consideration). Cash is received when control of a product transfers. The
entity’s customary business practice is to allow a customer to return any
unused product within 30 days and receive a full refund. The entity’s cost of
each product is CU60.

The entity applies the requirements in IFRS 15 to the portfolio of 100 contracts
because it reasonably expects that, in accordance with paragraph 4, the effects
on the financial statements from applying these requirements to the portfolio
would not differ materially from applying the requirements to the individual
contracts within the portfolio.

Because the contract allows a customer to return the products, the
consideration received from the customer is variable. To estimate the variable
consideration to which the entity will be entitled, the entity decides to use the
expected value method (see paragraph 53(a) of IFRS 15) because it is the
method that the entity expects to better predict the amount of consideration to
which it will be entitled. Using the expected value method, the entity estimates
that 97 products will not be returned.

The entity also considers the requirements in paragraphs 56–58 of IFRS 15 on
constraining estimates of variable consideration to determine whether the
estimated amount of variable consideration of CU9,700 (CU100 × 97 products
not expected to be returned) can be included in the transaction price. The
entity considers the factors in paragraph 57 of IFRS 15 and determines that
although the returns are outside the entity’s influence, it has significant
experience in estimating returns for this product and customer class. In
addition, the uncertainty will be resolved within a short time frame (i.e.,
the 30-day return period). Thus, the entity concludes that it is highly probable that
a significant reversal in the cumulative amount of revenue recognised (i.e.,
CU9,700) will not occur as the uncertainty is resolved (i.e, over the return
period).

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

Upon transfer of control of the 100 products, the entity does not recognise
revenue for the three products that it expects to be returned. Consequently, in
accordance with paragraphs 55 and B21 of IFRS 15, the entity recognises the
following:

(a) revenue of CU9,700 (CU100 × 97 products not expected to be
    returned);
(b) a refund liability of CU300 (CU100 refund × 3 products expected to be
    returned); and
(c) an asset of CU180 (CU60 × 3 products for its right to recover products
    from customers on settling the refund liability).
How we see it

The topic of product sales with rights of return is one that has not received as much attention as other topics for a variety of reasons. However, the changes in this area (primarily treating the right of return as a type of variable consideration to which the variable consideration requirements apply, including the constraint) may affect manufacturers and retailers that otherwise would not be significantly affected by IFRS 15. Entities will need to assess whether their current methods for estimating returns are appropriate, given the need to consider the constraint.

Summary of recent TRG discussions

**Accounting for restocking fees and related costs for goods that are expected to be returned**

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.

At the July 2015 TRG meeting, members of the TRG 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)].

TRG members generally agreed that restocking costs (e.g., shipping and repackaging costs) would be recorded as a reduction of the amount of the return asset when (or as) control of the good 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).

5.3 Significant financing component

For some transactions, the timing of the payment does not match the timing of the transfer of goods or services to the customer (e.g., the consideration is prepaid or is paid after the services are provided). When the customer pays in arrears, the entity is effectively providing financing to the customer. Conversely, when the customer pays in advance, the entity has effectively received financing from the customer. IFRS 15 states the following in relation to a significant financing component in a contract:
Extract from IFRS 15

60. In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

61. The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (ie the cash selling price). An entity shall consider all relevant facts and circumstances in assessing whether a contract contains a financing component and whether that financing component is significant to the contract, including both of the following:

   (a) the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services; and

   (b) the combined effect of both of the following:

      (i) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and

      (ii) the prevailing interest rates in the relevant market.

62. Notwithstanding the assessment in paragraph 61, a contract with a customer would not have a significant financing component if any of the following factors exist:

   (a) the customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer.

   (b) a substantial amount of the consideration promised by the customer is variable and the amount or timing of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the entity (for example, if the consideration is a sales-based royalty).

   (c) the difference between the promised consideration and the cash selling price of the good or service (as described in paragraph 61) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

63. As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.
An entity is not required to assess whether the contract contains a significant financing component unless the period between the customer’s payment and the entity’s transfer of the goods or services is greater than one year. It is not entirely clear in IFRS 15 whether entities would make this assessment at the contract level or at the performance obligation level. In addition, it is not clear how an entity that has a contract with more than one performance obligation would treat the financing. Questions remain regarding whether the entity would allocate the effects of the financing only to those performance obligations that are financed. That is, it is not clear whether an entity would determine whether it has a financing component at the contract level but then allocate the financing amounts at the performance obligation level.

Furthermore, unless the financing component is considered significant to the contract, entities will not be required to adjust the transaction price for the financing component. The assessment of significance is done at the individual contract level. The Boards decided that it would be an undue burden to require an entity to account for a financing component if the effects of the financing component are not significant to the individual contract, but the combined effects of the financing components for a portfolio of similar contracts would be material to the entity as a whole.

There will likely be significant judgement involved in determining whether a significant financing component exists when there is more than one year between the transfer of goods or services and the receipt of contract consideration. Entities will need to make sure that they have sufficiently documented their analyses to support their conclusions.

When an entity concludes that a financing component is significant to a contract, it determines the transaction price by discounting the amount of promised consideration. The entity uses the same discount rate that it would use if it were to enter into a separate financing transaction with the customer. The discount rate has to reflect the credit characteristics of the borrower in the contract; using the risk-free rate or a rate explicitly stated in the contract that does not correspond with a separate financing rate would not be acceptable. While this is not explicitly stated in the standard, an entity should consider the expected term of the financing when determining the discount rate in light of current market conditions at contract inception. The entity does not update the discount rate for changes in circumstances or interest rates after contract inception.

The standard includes the following examples to illustrate these concepts:

<table>
<thead>
<tr>
<th>Extract from IFRS 15</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Example 26 – Significant financing component and right of return (IFRS 15.IE135-IE140)</strong></td>
</tr>
<tr>
<td>An entity sells a product to a customer for CU121 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The contract permits the customer to return the product within 90 days. The product is new and the entity has no relevant historical evidence of product returns or other available market evidence.</td>
</tr>
<tr>
<td>The cash selling price of the product is CU100, which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception. The entity’s cost of the product is CU80.</td>
</tr>
</tbody>
</table>
Extract from IFRS 15 (cont’d)

The entity does not recognise revenue when control of the product transfers to the customer. This is because the existence of the right of return and the lack of relevant historical evidence means that the entity cannot conclude that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur in accordance with paragraphs 56–58 of IFRS 15. Consequently, revenue is recognised after three months when the right of return lapses.

The contract includes a significant financing component, in accordance with paragraphs 60–62 of IFRS 15. This is evident from the difference between the amount of promised consideration of CU121 and the cash selling price of CU100 at the date that the goods are transferred to the customer.

The contract includes an implicit interest rate of 10 per cent (ie the interest rate that over 24 months discounts the promised consideration of CU121 to the cash selling price of CU100). The entity evaluates the rate and concludes that it is commensurate with the rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception.

The following journal entries illustrate how the entity accounts for this contract in accordance with paragraphs B20–B27 of IFRS 15.

(a) When the product is transferred to the customer, in accordance with paragraph B21 of IFRS 15:

- Asset for right to recover product to be returned CU80
- Inventory CU80

(a) This example does not consider expected costs to recover the asset.

(b) During the three-month right of return period, no interest is recognised in accordance with paragraph 65 of IFRS 15 because no contract asset or receivable has been recognised.

(c) When the right of return lapses (the product is not returned):

- Receivable CU100
- Revenue CU100
- Cost of sales CU80
- Asset for product to be returned CU80

(a) The receivable recognised would be measured in accordance with IFRS 9. This example assumes there is no material difference between the fair value of the receivable at contract inception and the fair value of the receivable when it is recognised at the time the right of return lapses. In addition, this example does not consider the impairment accounting for the receivable.

Until the entity receives the cash payment from the customer, interest revenue would be recognised in accordance with IFRS 9. In determining the effective interest rate in accordance with IFRS 9, the entity would consider the remaining contractual term.
Example 28 – Determining the discount rate (IFRS 15.IE143-IE147)
An entity enters into a contract with a customer to sell equipment. Control of the equipment transfers to the customer when the contract is signed. The price stated in the contract is CU1 million plus a five per cent contractual rate of interest, payable in 60 monthly instalments of CU18,871.

Case A—Contractual discount rate reflects the rate in a separate financing transaction
In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the five per cent contractual rate of interest reflects the rate that would be used in a separate financing transaction between the entity and its customer at contract inception (ie the contractual rate of interest of five per cent reflects the credit characteristics of the customer).

The market terms of the financing mean that the cash selling price of the equipment is CU1 million. This amount is recognised as revenue and as a loan receivable when control of the equipment transfers to the customer. The entity accounts for the receivable in accordance with IFRS 9.

Case B—Contractual discount rate does not reflect the rate in a separate financing transaction
In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the five per cent contractual rate of interest is significantly lower than the 12 per cent interest rate that would be used in a separate financing transaction between the entity and its customer at contract inception (ie the contractual rate of interest of five per cent does not reflect the credit characteristics of the customer). This suggests that the cash selling price is less than CU1 million.

In accordance with paragraph 64 of IFRS 15, the entity determines the transaction price by adjusting the promised amount of consideration to reflect the contractual payments using the 12 per cent interest rate that reflects the credit characteristics of the customer. Consequently, the entity determines that the transaction price is CU848,357 (60 monthly payments of CU18,871 discounted at 12 per cent). The entity recognises revenue and a loan receivable for that amount. The entity accounts for the loan receivable in accordance with IFRS 9.

How we see it
IFRS 15 requires that the discount rate is similar to the rate the entity would have used in a separate financing transaction with the customer at contract inception. Most entities are not in the business of entering into free-standing financing arrangements with their customers. As such, it may be difficult to identify an appropriate rate.

Most entities, however, perform some level of credit analysis before financing purchases for a customer. Therefore, they will have some information about the customer’s credit risk. For entities that have different pricing for products depending on the time of payment (e.g., cash discounts), IFRS 15 indicates that an appropriate discount rate could be determined by identifying the rate that discounts the nominal amount of the promised consideration to the cash sales price of the good or service.
5.3.1 Financial statement presentation of financing component
The financing component of the transaction price is presented separately from the revenue recognised. Upon satisfaction of the performance obligations, an entity recognises the present value of the promised consideration as revenue. The financing component is recognised as interest expense (when the customer pays in advance) or interest income (when the customer pays in arrears). The interest income or expense is recognised over the financing period using the effective interest method described in IFRS 9 or IAS 39. The Boards noted that an entity may present interest income as revenue only when interest income represents income from an entity’s ordinary activities (e.g., banks that regularly enter into financing transactions and have other interest income that represents income arising from ordinary activities).

Impairment losses on receivables, with or without a significant financing component, are presented in line with the requirements of IAS 1 Presentation of Financial Statements and disclosed in accordance with IFRS 7 Financial Instruments: Disclosures. However, IFRS 15 makes it clear that such amounts are disclosed separately from impairment losses from other contracts.98

<table>
<thead>
<tr>
<th>Summary of recent TRG discussions</th>
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<tbody>
<tr>
<td>Considerations for identifying significant financing components</td>
</tr>
<tr>
<td>Following the issuance of the new standards, stakeholders have raised many questions about the requirements for identifying a significant financing component. While current IFRS and US GAAP include requirements on accounting for the time value of money in a revenue transaction, the requirements in the new revenue standards represent a change from existing practice, in particular, because it applies to advance payments as well as payments in arrears.</td>
</tr>
<tr>
<td>a) Existence of a financing component when the promised consideration is equal to the cash selling price</td>
</tr>
<tr>
<td>Under IFRS 15, 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.99 At the March 2015 TRG meeting, members of the TRG were asked to consider whether a financing component exists if the promised consideration is equal to the cash selling price.</td>
</tr>
<tr>
<td>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.</td>
</tr>
<tr>
<td>b) Payment terms reflect reasons other than the provision of finance</td>
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<td>According to IFRS 15, a significant financing component does not exist if the difference between the promised consideration and the cash selling price of the good or service arises for reasons other than the provision of finance.100 At the March 2015 TRG meeting, members of the TRG discussed whether this factor should be broadly or narrowly applied.</td>
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98 IFRS 15.113(b)  
99 IFRS 15.61(a)  
100 IFRS 15.62(c)
Summary of recent TRG discussions (cont’d)

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.

c) Determining whether the significant financing component practical expedient applies to contracts with a single payment stream for multiple performance obligations

A practical expedient in IFRS 15 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. Members of the TRG were asked, at the March 2015 TRG meeting, how entities should consider whether the practical expedient applies to contracts with a single payment stream for multiple performance obligations.

TRG members generally agreed that entities will either:

- Apply any consideration received to the earliest good or service delivered; or
- Allocate it proportionately between the goods and services depending on the facts and circumstances.

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

Approach (2) above may be appropriate in circumstances similar to the example in the agenda paper, when the cash payment is not directly tied to a particular good or service in a contract. However, approach (1) may be appropriate when the cash payment is directly tied to a particular good or service.

d) Existence of a significant financing component: customer option that provides a material right

Stakeholders have questioned whether an entity is required to evaluate whether a customer option that provides a material right includes a significant financing component and, if so, how entities would perform this evaluation. Members of the TRG discussed this question during the March 2015 TRG meeting.

101 IFRS 15.63
102 TRG Agenda paper 30, Significant Financing Components, dated 30 March 2015
Summary of recent TRG discussions (cont’d)

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.

The agenda paper103 discussed a factor that may be determinative in this evaluation. IFRS 15 indicates that if a customer provides advance payment for a good or service, but the customer can choose when the good or service is transferred, no significant financing component exists.104 As a result, if the customer can choose when to exercise the option, there may not be a significant financing component.

Accounting for significant financing components

a) Calculating the adjustment to revenue for significant financing components

At the March 2015 TRG meeting, members of the TRG discussed how an entity would calculate the adjustment to revenue for contracts that include a significant financing component. TRG members generally agreed that the standards do not contain requirements for 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 IFRS 15 to determine the appropriate accounting treatment (i.e., IFRS 9 or IAS 39).

b) Allocating a significant financing component when there are multiple performance obligations in a contract

Stakeholders have questioned how an entity would allocate a significant financing component when there are multiple performance obligations in a contract.

At the March 2015 TRG meeting, members of the TRG discussed this question and noted that the new revenue standards are clear that, when determining the transaction price, the effect of financing is excluded from the transaction price prior to the allocation of the transaction price to performance obligations. However, TRG members generally agreed with the Boards’ staff view in the agenda paper105 that “it may be reasonable in some circumstances to attribute a significant financing component to one or more, but not all, of the performance obligations in the contract.” Practically, this might be done by analogue to the exceptions for allocating variable consideration and/or discounts to one or more (but not all) performance obligations, if specified criteria are met (see Sections 6.3 and 6.4 below). However, some TRG members noted that it may be difficult to require allocation to specific performance obligations because cash is fungible.

c) Accounting for financing components that are not significant

At the March 2015 TRG meeting, members of the TRG 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 for an insignificant financing component needs to be consistent in its application to all similar contracts with similar circumstances.

103 TRG Agenda paper 32, Accounting for a Customer’s Exercise of a Material Right, dated 30 March 2015
104 IFRS 15.62(a)
5.4 Non-cash consideration

Customer consideration might be in the form of goods, services or other non-cash consideration. When an entity (i.e., the seller or vendor) receives, or expects to receive, non-cash consideration, the fair value of the non-cash consideration is included in the transaction price.

An entity applies the requirements of IFRS 13 *Fair Value Measurement* when measuring the fair value of any non-cash consideration. If an entity cannot reasonably estimate the fair value of non-cash consideration, it measures the non-cash consideration indirectly by reference to the estimated stand-alone selling price of the promised goods or services.

For contracts with both non-cash consideration and cash consideration, an entity will need to measure the fair value of the non-cash consideration and it will look to other requirements within IFRS 15 to account for the cash consideration. For example, for a contract in which an entity receives non-cash consideration and a sales-based royalty, the entity would measure the fair value of the non-cash consideration and refer to the requirements within the standard for the sales-based royalties.

The fair value of non-cash consideration may change because of the occurrence (or non-occurrence) of a future event or because of the form of consideration (e.g., a change in the price of a share that an entity is entitled to receive from a customer). Under IFRS 15, if an entity's entitlement to non-cash consideration promised by a customer is variable for reasons other than the form of consideration (i.e., there is uncertainty as to whether the entity will receive the non-cash consideration), the entity considers the constraint on variable consideration.

In some transactions, a customer contributes goods or services, such as equipment or labour, to facilitate the fulfilment of the contract. If the entity obtains control of the contributed goods or services, it would consider them non-cash consideration and account for that consideration as described above.

The Boards also noted that any assets recognised as a result of non-cash consideration are accounted for in accordance with other relevant standards (e.g., IAS 16).

**What's changing from current IFRS?**

The concept of accounting for non-cash consideration at fair value is consistent with current IFRS. IAS 18 requires non-cash consideration to be measured at the fair value of the goods or services received. When this amount cannot be measured reliably, non-cash consideration is measured at the fair value of the goods or services given up.\(^{106}\) IFRIC 18 also requires any revenue recognised as a result of a transfer of an assets from a customer to be measured,\(^{107}\) consistent with the requirement in IAS 18. Therefore, we do not expect IFRS 15 to result in a change to current practice.

SIC-31 specifies that a seller can reliably measure revenue at the fair value of the advertising services it provides in a barter transaction, by reference to non-barter transactions that meet specified criteria. IFRS 15 does not contain similar requirements. Therefore, more judgement of the specific facts and circumstances will be necessary when accounting for advertising barter transactions.

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\(^{106}\) IAS 18.12  
\(^{107}\) IFRIC 18.13
Example 31 – Entitlement to non-cash consideration (IFRS 15.IE156-IE158)

An entity enters into a contract with a customer to provide a weekly service for one year. The contract is signed on 1 January 20X1 and work begins immediately. The entity concludes that the service is a single performance obligation in accordance with paragraph 22(b) of IFRS 15. This is because the entity is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress—that is, a time-based measure of progress).

In exchange for the service, the customer promises 100 shares of its common stock per week of service (a total of 5,200 shares for the contract). The terms in the contract require that the shares must be paid upon the successful completion of each week of service.

The entity measures its progress towards complete satisfaction of the performance obligation as each week of service is complete. To determine the transaction price (and the amount of revenue to be recognised), the entity measures the fair value of 100 shares that are received upon completion of each weekly service. The entity does not reflect any subsequent changes in the fair value of the shares received (or receivable) in revenue.

5.4.1 Non-cash consideration implementation considerations

Stakeholders have raised questions about the date that should be used when measuring the fair value of non-cash consideration for inclusion within the transaction price. In addition, constituents noted that the variability of non-cash consideration could arise both from its form (e.g., shares) and for other reasons (e.g., performance factors that affect the amount of consideration to which the entity will be entitled). Consequently, they questioned how the constraint on variable consideration would be applied in such circumstances.

At the January 2015 TRG meeting, members of the TRG discussed these questions and agreed that, while the standard requires non-cash consideration (e.g., shares, advertising provided as consideration from a customer) to be measured at fair value, it is unclear when that fair value measurement must occur. Members of the TRG discussed three measurement date options: contract inception; when it is received; or when the related performance obligation is satisfied. Each view received support from some TRG members.

The standard also requires that the constraint on variable consideration be applied to non-cash consideration only if the variability is due to factors other than the form of consideration (i.e., it is unclear whether the entity will collect the consideration). The constraint will not apply if the non-cash consideration varies because of its form (e.g., listed shares that change in price). However, the standard does not address how the constraint would be applied when the non-cash consideration is variable due to both its form and other reasons. While some TRG members said the standard could be interpreted to require an entity to split the consideration based on the source of the variability, some members highlighted that this approach would be overly complex and would not provide useful information.
In response, in September 2015, the FASB proposed that the fair value of non-cash consideration would be measured at contract inception when determining the transaction price. Any subsequent changes in the fair value of the non-cash consideration due to its form (e.g., changes in share price) are not included in the transaction price and would be recognised, if required, as a gain or loss in accordance with other accounting standards, but would not be recognised as revenue from contracts with customers. The FASB also proposed to clarify that when the variability of non-cash consideration is due to both the form of the consideration and for other reasons, the constraint on variable consideration would apply only to the variability for reasons other than its form.

At the March 2015 joint Board meeting, the IASB observed that this issue has important interactions with other standards (including IFRS 2 Share-based Payment and IAS 21 The Effects of Changes in Foreign Exchange Rates) and there was concern about proposing changes as there is a risk of unintended consequences. The Board decided that, if needed, these issues be considered more comprehensively in a separate project.\(^\text{108}\)

In the Basis for Conclusions to its July 2015 exposure draft, the IASB acknowledged that, since it is not proposing a change equivalent to that of the FASB, “the use of a measurement date other than contract inception would not be precluded under IFRS. Consequently, it is possible that diversity between IFRS and US GAAP entities could arise in practice. The IASB observed that, unlike US GAAP, existing IFRS does not contain any specific requirements about the measurement date for non-cash consideration for revenue transactions. Therefore, IFRS 15 is not expected to create more diversity than presently exists in respect of this issue. In addition, discussions with some stakeholders highlighted that any practical effect of different measurement dates would arise in only limited circumstances. The IASB also noted that, if significant, an entity would be required to disclose the accounting policy applied.”\(^\text{109}\)

5.5 Consideration paid or payable to a customer

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

\(^{108}\) Exposure draft ED/2015/6, Clarifications to IFRS 15, paragraph BC100

\(^{109}\) Exposure draft ED/2015/6, Clarifications to IFRS 15, paragraph BC102
The standard provides the following requirements for consideration paid or payable to a customer:

**Extract from IFRS 15**

70. Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity’s goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity’s goods or services from the customer). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 26-30) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 50-58.

71. If consideration payable to a customer is a payment for a distinct good or service from the customer, then an entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers. If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that the entity receives from the customer, then the entity shall account for such an excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, it shall account for all of the consideration payable to the customer as a reduction of the transaction price.

72. Accordingly, if consideration payable to a customer is accounted for as a reduction of the transaction price, an entity shall recognise the reduction of revenue when (or as) the later of either of the following events occurs:

(a) the entity recognises revenue for the transfer of the related goods or services to the customer; and

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

The standard indicates that an entity accounts for the consideration payable to a customer, regardless of whether the purchaser receiving the consideration is a direct or indirect customer of the entity. This includes consideration to any purchasers of the entity’s products at any point along the distribution chain. The requirements apply to entities that derive revenue from sales of services, as well as entities that derive revenue from sales of goods.

Consideration paid or payable to customers commonly takes the form of discounts and coupons, among others. In addition, some entities make payments to the customers of resellers or distributors that purchase directly from the entity (e.g., manufacturers of breakfast cereals offer coupons to consumers, even though their direct customers are the grocery stores that sell to consumers). Furthermore, the promise to pay the consideration might be implied by the entity’s customary business practice. To determine the appropriate accounting treatment, an entity must first determine whether: the consideration paid or payable to a customer is a payment for a distinct good or service; a reduction of the transaction price; or a combination of both.
For a payment by the entity to a customer to be treated as something other than a reduction of the transaction price, the good or service provided by the customer must be distinct (as discussed in Section 4.2.1).

If the consideration paid or payable to a customer is a discount or refund for goods or services provided to a customer, this reduction of the transaction price (and thus, ultimately, revenue) is 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. This is true even if the payment is conditional on a future event. For example, if goods subject to a discount through a coupon are already on the shelves of retailers, the discount would be recognised when the coupons are issued. However, if a coupon is issued that can be used on a new line of products that have not yet been sold to retailers, the discount would be recognised upon sale of the products to a retailer.

The consideration paid or payable to a customer may include variable consideration in the form of a discount or refund for goods or services provided. If so, an entity would use either the expected value approach or most likely amount to estimate the amount to which the entity expects to be entitled and apply the constraint to the estimate (see Section 5.1 for further discussion) to determine the effect of the discount or refund.

However, the requirement on the timing of when consideration payable to a customer would be recognised appears to be inconsistent with the requirement to consider implied price concessions. That is, IFRS 15’s definition of variable consideration is broad enough to include amounts such as coupons or other forms of credits that can be applied to the amounts owed. The standard requires that all potential variable consideration be considered and reflected in the transaction price at inception and as the entity performs. This means that if an entity has a history of providing this type of consideration to its customers, the requirements on estimating variable consideration suggest that such amounts need to be considered at the contract inception, even if the entity has not yet provided this consideration to the customer.

The inconsistency arises as the specific requirements on ‘consideration payable to a customer’ state that such amounts are not recognised as a reduction of revenue until the later of:
- When the related sales are recognised;
- Or
- The entity promises to provide such consideration

A literal read of these requirements seems to suggest that an entity need not anticipate offering these types of programmes, even if it has a history of doing so, and only recognises the effect of these programmes when they have already been paid or promised to the customer. See below for a summary of recent TRG discussions on this matter.

Consideration paid to a customer can take many different forms. Therefore, entities will have to carefully evaluate each transaction to determine the appropriate treatment of such amounts. Some common examples of consideration paid to a customer include:

- **Slotting fees** – Manufacturers of consumer products commonly pay retailers fees to have their goods displayed prominently on store shelves. Those shelves can be physical (i.e., in a building where the store is located) or virtual (i.e., they represent space in an internet reseller’s online catalogue). Generally, such fees do not provide a distinct good or service to the manufacturer and are treated as a reduction of the transaction price.
- **Co-operative advertising arrangements** – In some arrangements, a vendor agrees to reimburse a reseller for a portion of costs incurred by the reseller to advertise the vendor’s products. The determination of whether the payment from the vendor is in exchange for a distinct good or service at fair value will depend on a careful analysis of the facts and circumstances of the contract.

- **Price protection** - A vendor may agree to reimburse a retailer up to a specified amount for shortfalls in the sales price received by the retailer for the vendor’s products over a specified period of time. Normally such fees do not provide a distinct good or service to the manufacturer and are treated as a reduction of the transaction price.

- **Coupons and rebates** - An indirect customer of a vendor may receive a refund of a portion of the purchase price of the product or service acquired by returning a form to the retailer or the vendor. Generally, such fees do not provide a distinct good or service to the manufacturer and are treated as a reduction of the transaction price.

- **’Pay-to-play’ arrangements** – In some arrangements, a vendor pays an upfront fee to the customer in order to obtain a new contract. In most cases, these payments are not associated with any distinct good or service to be received from the customer and are treated as a reduction of the transaction price.

- **Purchase of goods or services** – Entities often enter into supplier-vendor arrangements with their customers in which the customers provide them with a distinct good or service. For example, a software entity may buy its office supplies from one of its software customers. In such situations, the entity has to carefully determine whether the payment made to the customer is solely for the goods and services received, or whether part of the payment is actually a reduction of the transaction price for the goods and services the entity is transferring to the customer.

IFRS 15’s accounting for consideration payable to a customer is generally consistent with current practice under IFRS. However, the requirement to determine whether a good or service is ‘distinct’ in order to treat the consideration payable to a customer as anything other than a reduction of revenue is new. While it is implied in many of the illustrative examples to IAS 18, it is not explicitly discussed in current IFRS. As such, some entities may need to reassess the treatment of consideration paid or payable to a customer.
The standard includes the following example on this topic:

**Extract from IFRS 15**

**Example 32 – Consideration payable to a customer (IFRS 15.IE160-IE162)**

An entity that manufactures consumer goods enters into a one-year contract to sell goods to a customer that is a large global chain of retail stores. The customer commits to buy at least CU15 million of products during the year. The contract also requires the entity to make a non-refundable payment of CU1.5 million to the customer at the inception of the contract. The CU1.5 million payment will compensate the customer for the changes it needs to make to its shelving to accommodate the entity’s products.

The entity considers the requirements in paragraphs 70–72 of IFRS 15 and concludes that the payment to the customer is not in exchange for a distinct good or service that transfers to the entity. This is because the entity does not obtain control of any rights to the customer’s shelves. Consequently, the entity determines that, in accordance with paragraph 70 of IFRS 15, the CU1.5 million payment is a reduction of the transaction price.

The entity applies the requirements in paragraph 72 of IFRS 15 and concludes that the consideration payable is accounted for as a reduction in the transaction price when the entity recognises revenue for the transfer of the goods. Consequently, as the entity transfers goods to the customer, the entity reduces the transaction price for each good by 10 per cent (CU1.5 million ÷ CU15 million). Therefore, in the first month in which the entity transfers goods to the customer, the entity recognises revenue of CU1.8 million (CU2.0 million invoiced amount less CU0.2 million of consideration payable to the customer).

**Summary of recent TRG discussions**

**Payments to a customer that are within the scope of the requirements for consideration payable to a customer**

At both the March 2015 and July 2015 TRG meetings, members of the TRG discussed which payments made to a customer would be within the scope of the requirements for consideration payable to a customer.

TRG members generally agreed that an entity may not need to separately analyse each payment to a customer if it is apparent that the payment is for a distinct good or service acquired in the normal course of business at 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 good or services, the payment needs to be evaluated under these requirements.

**Determining who is an entity’s customer when applying the requirements for consideration payable to a customer**

When applying the requirements for consideration payable to a customer, it is important to determine who is the entity’s customer. At both the March 2015 and July 2015 TRG meetings, members of the TRG discussed whether an entity would need to consider entities in the distribution chain when applying these requirements.
Summary of recent TRG discussions (cont’d)

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 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 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.

Recognising variable consideration that is payable to a customer

The description of variable consideration in IFRS 15 is broad and includes price concessions, refunds, incentives, and other payments to a customer (see Section 5.1.1 above). TRG members’ discussions in March 2015 and July 2015 highlighted that some stakeholders thought the guidance on the timing of recognition of consideration payable to a customer may not reconcile to the guidance on including estimates of variable consideration in the transaction price.

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 (discussed in above), 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.

However, some TRG members noted that this conflict may not arise frequently. As such, TRG members did not support amending the standards.

5.6 Non-refundable upfront fees

In certain circumstances, entities may receive payments from customers before they provide the contracted service or deliver a good. Upfront fees generally relate to the initiation, activation or set-up of a good to be used or a service to be provided in the future. Upfront fees also may be paid to grant access to or to provide a right to use a facility, product or service. In many cases, the upfront amounts paid by the customer are non-refundable. Examples include fees paid for membership to a health club or buying club and activation fees for phone, cable or internet services.

Entities must evaluate whether non-refundable upfront fees relate to the transfer of a good or service. In many situations, an upfront fee represents an advance payment for future goods or services. In addition, the existence of a non-refundable upfront fee may indicate that the arrangement includes a renewal option for future goods and services at a reduced price (if the customer renews the agreement without the payment of an additional upfront fee).
Illustration 5-2 – Non-refundable upfront fees

A customer signs a one-year contract with a health club and is required to pay both a non-refundable initiation fee of CU150 and an annual membership fee in monthly instalments of CU40. The club’s activity of registering the customer does not transfer any service to the customer and, therefore, is not a performance obligation. By not requiring the customer to pay the upfront membership fee again at renewal, the club is effectively providing a discounted renewal rate to the customer.

The club determines that the renewal option is a material right because it provides a renewal option at a lower price than the range of prices typically charged and, therefore, it is a separate performance obligation. Based on its experience, the club determines that its customers, on average, renew their annual memberships twice before terminating their relationship with the club. As a result, the club determines that the option provides the customer with the right to two annual renewals at a discounted price.

In this scenario, the club would allocate the total transaction consideration of CU630 (CU150 upfront membership fee + CU480 (CU40 x 12 months)) to the identified performance obligations (monthly services and renewal option) based on the relative stand-alone selling price method. The amount allocated to the renewal option would be recognised as each of the two renewal periods is either exercised or forfeited.

Alternatively, the club could value the option by ‘looking through’ to the optional goods and services. In that case, the club would determine that the total transaction price is the sum of the upfront fee plus three years of monthly service fees (i.e., CU150 + CU1,440) and would allocate that amount to all of the services expected to be delivered, or 36 months of membership (i.e., CU44.17 per month).

See Section 4.6 for a more detailed discussion on the treatment of options.

Summary of recent TRG discussions

Recognition period for a non-refundable upfront fee that does not relate to the transfer of a good or service

At the March 2015 TRG meeting, members of the TRG were asked over which period an entity should 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 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).
6 Allocate the transaction price to the performance obligations

Once the separate performance obligations are identified and the transaction price has been determined, the standard requires an entity to allocate the transaction price to the performance obligations. This is generally done in proportion to their stand-alone selling prices (i.e., on a relative stand-alone selling price basis). As a result, any discount within the contract generally is allocated proportionally to all of the separate performance obligations in the contract.

However, as discussed further below, there are some exceptions. For example, an entity could allocate variable consideration to a single performance obligation in some situations. IFRS 15 also contemplates the allocation of any discount in a contract to only certain performance obligations, if specified criteria are met.

6.1 Estimating stand-alone selling prices

To allocate the transaction price on a relative stand-alone selling price basis, an entity must first determine the stand-alone selling price for each performance obligation. Under the standard, this is the price at which an entity would sell a good or service on a stand-alone basis at contract inception.

IFRS 15 indicates the observable price of a good or service sold separately provides the best evidence of stand-alone selling price. However, in many situations, stand-alone selling prices will not be readily observable. In those cases, the entity must estimate the stand-alone selling price.

The estimate of stand-alone selling prices is performed at contract inception and is not updated to reflect changes between contract inception and when performance is complete. For example, assume an entity determines the stand-alone selling price for a promised good and, before it can manufacture and deliver that good, the underlying cost of the materials doubles. In such a situation, the entity would not revise its estimate of the stand-alone selling price used for this contract. However, for future arrangements involving the same good, the entity would need to use a revised stand-alone selling price (see Section 6.1.3). Furthermore, if the contract is modified and that modification is not treated as a separate contract, the entity would update its estimate of the stand-alone selling price at the time of the modification (see Section 6.5).

What's changing from current IFRS?

The new requirements for the allocation of the transaction price to performance obligations could result in a change in practice for many entities.

IAS 18 does not prescribe an allocation method for multiple-element arrangements. IFRIC 13 mentions two allocation methodologies: allocation based on relative fair value; and allocation using the residual method. However, IFRIC 13 does not prescribe a hierarchy. Therefore, currently an entity must use its judgement to select the most appropriate methodology, taking into consideration all relevant facts and circumstances and ensuring the resulting allocation is consistent with IAS 18's objective to measure revenue at the fair value of the consideration.
Given the limited guidance in current IFRS on multiple-element arrangements, some entities have looked to US GAAP to develop their accounting policies. The requirement to estimate a stand-alone selling price will not be a new concept for entities that have developed their accounting policies by reference to the multiple-element arrangements requirements in ASC 605-25. The requirements in IFRS 15 for estimating a stand-alone selling price are generally consistent with ASC 605-25, except that they do not require an entity to consider a hierarchy of evidence to make this estimate.

Under US GAAP, some entities have adopted the provisions of ASC 605-25 by developing estimates of selling prices for elements within an arrangement that may exhibit ‘highly variable’ pricing, as described in Section 6.1.2. IFRS 15 may allow those entities to revert to a residual approach (similar to the accounting for these elements before the FASB issued what was then new multiple-element requirements in 2009).

The requirement to estimate a stand-alone selling price may be a significant change for entities reporting under IFRS that have looked to other US GAAP requirements to develop their accounting policies for revenue recognition, such as the software revenue recognition requirements in ASC 985-605. Those requirements have a different threshold for determining the stand-alone selling price, requiring observable evidence and not management estimates. Some of these entities may find it difficult to determine a stand-alone selling price, particularly for goods or services that are never sold separately (e.g., specified upgrade rights for software). In certain circumstances, an entity may be able to estimate the stand-alone selling price of a performance obligation using a ‘residual approach’ (See Section 6.1.2).

How we see it

We anticipate that personnel responsible for an entity’s revenue recognition policies will need to consult with personnel beyond those in the accounting or finance departments. Specifically, they would need to consult with personnel that are involved in the entity’s pricing decisions in order to determine estimated stand-alone selling prices, especially when there are limited or no observable inputs. This may be a change for some entities.

In relation to estimating stand-alone selling price, the standard provides the following requirements:

### Extract from IFRS 15

78. If a stand-alone selling price is not directly observable, an entity shall estimate the stand-alone selling price at an amount that would result in the allocation of the transaction price meeting the allocation objective in paragraph 73. When estimating a stand-alone selling price, an entity shall consider all information (including market conditions, entity-specific factors and information about the customer or class of customer) that is reasonably available to the entity. In doing so, an entity shall maximise the use of observable inputs and apply estimation methods consistently in similar circumstances.
79. Suitable methods for estimating the stand-alone selling price of a good or service include, but are not limited to, the following:

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

(b) Expected cost plus a margin approach—an entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service.

(c) Residual approach—an entity may estimate the stand-alone selling price by reference to the total transaction price less the sum of the observable stand-alone selling prices of other goods or services promised in the contract. However, an entity may use a residual approach to estimate, in accordance with paragraph 78, the stand-alone selling price of a good or service only if one of the following criteria is met:

(i) the entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts (ie the selling price is highly variable because a representative stand-alone selling price is not discernible from past transactions or other observable evidence); or

(ii) the entity has not yet established a price for that good or service and the good or service has not previously been sold on a stand-alone basis (ie the selling price is uncertain).

6.1.1 Factors to consider when estimating the stand-alone selling price

The standard states that when estimating the stand-alone selling price, an “entity shall consider all information (including market conditions, entity-specific factors and information about the customer or class of customer) that is reasonably available to the entity”. This is a very broad requirement and will require an entity to consider a variety of data sources.

While not an all-inclusive list, the following are examples of market conditions to consider:

- Potential limitations on the selling price of the product
- Competitor pricing for a similar or identical product
- Market awareness and perception of the product
- Current market trends that will likely affect the pricing
- The entity’s market share and position (e.g., the entity’s ability to dictate pricing)
- Effects of the geographic area on pricing
- Effects of customisation on pricing
- Expected technological life of the product

110 IFRS 15.78
Examples of entity-specific factors include:

- Profit objectives and internal cost structure
- Pricing practices and pricing objectives (including desired gross profit margin)
- Effects of customisation on pricing
- Pricing practices used to establish pricing of bundled products
- Effects of the proposed transaction on pricing (e.g., the size of the deal, the characteristics of the targeted customer)
- The expected technological life of the product, including significant vendor-specific technological advancements expected in the near future

An entity’s documentation of its estimated stand-alone selling price, especially if there is limited or no observable data, will likely need to be sufficiently robust to demonstrate how it considered the types of factors listed above in reaching its estimate.

### 6.1.2 Possible estimation methods

IFRS 15 discusses three estimation methods: (1) the adjusted market assessment approach; (2) the expected cost plus a margin approach; and (3) a residual approach. All of these are discussed further below. When applying IFRS 15, an entity may need to use a combination of these methods to estimate a stand-alone selling price. Furthermore, these are not the only estimation methods permitted. IFRS 15 allows any reasonable estimation method, as long as it is consistent with the notion of a stand-alone selling price, maximises the use of observable inputs and is applied on a consistent basis for similar goods and services and customers.

In some cases, an entity may have sufficient observable data to determine the stand-alone selling price. For example, an entity may have sufficient stand-alone sales of a particular good or service that provide persuasive evidence of the stand-alone selling price of a particular good or service. In such situations, no estimation would be necessary.

In many instances, an entity may not have sufficient stand-alone sales data to determine the stand-alone selling price based solely on those stand-alone sales. In those instances, it must maximise the use of whatever observable inputs it has available in order to make its estimate, i.e., an entity does not disregard any observable inputs when estimating the stand-alone selling price of a good or service.

To make this estimate, an entity may use one or a combination of the following methods mentioned in the standard:

- **Adjusted market assessment approach** – this approach focuses on the amount that the entity believes the market is willing to pay for a good or service. This approach is based primarily on external factors rather than the entity’s own internal influences. When using the adjusted market assessment approach, an entity considers market conditions, such as those listed in Section 6.1.1. Applying this approach will likely be easiest when an entity has sold the good or service for a period of time (so it has data about customer demand), or a competitor offers competing goods or services that the entity can use as a basis for its analysis. Applying this approach may be difficult when an entity is selling an entirely new good or service because it may be difficult to anticipate market demand. We anticipate entities may want to use the market assessment approach in combination with other approaches to maximise the use of observable inputs (e.g., the market
assessment approach combined with an entity’s planned internal pricing strategies if the performance obligation has never been sold separately).

- **Expected cost plus margin approach** – this approach focuses primarily on internal factors (e.g., the entity’s cost basis), but has an external component as well. That is, the margin included in this approach must reflect the margin rate the market would be willing to pay, not just the entity’s desired margin. The margin may need to be adjusted for differences in products, geographies, customers and other factors. The expected cost plus margin approach may be useful in many situations, especially when the related performance obligation has a determinable direct fulfilment cost (see Section 8.3.2). However, this approach may be less helpful when the direct fulfilment costs are not clearly identifiable or are not known.

- **Residual approach** – the residual approach assumes an entity can estimate the stand-alone selling prices for all but one of the promised goods or services. In such circumstances, the residual approach allows an entity to allocate the remainder of the transaction price, or the residual amount, to the good or service for which it could not reasonably make an estimate. Since the standard indicates that this method can only be applied for multiple-element transactions when the selling price of a single good or service is not known (either because the historical selling price was highly variable or because the good or service has not yet been sold). As a result, we anticipate the use of this method likely will be limited. However, allowing entities to use a residual technique will provide relief to those that rarely or never sell goods or services on a stand-alone basis, such as entities that sell intellectual property only with physical goods or services.

Assume, for example, that an entity frequently sells software, professional services and maintenance, bundled together, at prices that vary widely. The entity also sells the professional services and maintenance deliverables individually at relatively stable prices. The Boards indicated that it may be appropriate to estimate the stand-alone selling price for the software using the residual approach. That is, the estimated price for the software would be the difference between the total transaction price and the estimated selling price of the professional services and maintenance. See Example 34 Cases B and C in Section 6.4 for examples of when the residual approach may or may not be appropriate.

IFRS 15 is clear that an entity may need to use a combination of these (or other) methods to develop an estimate of the stand-alone selling price. It cites situations in which two or more performance obligations have highly variable or uncertain stand-alone pricing. For example, assume an entity enters into a contract with five performance obligations, two of which have highly variable pricing. The entity may use the residual approach to determine the total amount to allocate to the two highly-variable performance obligations. Then it may use another approach to determine how to allocate that total amount between the two performance obligations.

Regardless of whether the entity uses a single method or a combination of methods to estimate the stand-alone selling price, the entity would evaluate whether the resulting allocation of the transaction price is consistent with the overall allocation objective and the requirements for estimating stand-alone selling prices.
In accordance with IFRS 15, an entity must make a reasonable estimate of the stand-alone selling price for each performance obligation. In developing this requirement, the Boards believed that, even in instances in which limited information is available, entities should have sufficient information to develop a reasonable estimate.

**How we see it**

Estimating stand-alone selling prices may require a change in practice. IAS 18 does not prescribe an allocation method for multiple-element arrangements. As a result, entities have used a variety of methods, which may not be based on current selling prices.

In addition, entities that have developed their accounting policies by reference to the US GAAP requirements in ASC 605-25 should note that there will no longer be a hierarchy such as is in that standard, which requires them to first consider vendor-specific objective evidence (VSOE), then third-party evidence and, finally, best estimate of selling price. In addition, entities that have looked to current requirements in ASC 985-605 to develop their accounting policies will no longer need to establish VSOE based on a significant majority of their transactions.

As a result, we expect that many entities will need to establish methods to estimate their stand-alone selling prices. However, as these estimates may have limited underlying observable data, it will be important for entities to have robust documentation to demonstrate the reasonableness of the calculations they make in determining stand-alone selling prices.

6.1.3 Updating estimated stand-alone selling prices

IFRS 15 does not specifically address how frequently estimated stand-alone selling prices must be updated. Instead, it indicates that an entity must make this estimate for each transaction, which suggests constantly updating prices.

In practice, we anticipate that entities will be able to consider their own facts and circumstances in order to determine how frequently they will need to update their estimates. If, for example, the information used to estimate the stand-alone selling price for similar transactions has not changed, an entity may determine that it is reasonable to use the previously determined stand-alone selling price. However, to ensure that changes in circumstances are reflected in the estimate in a timely manner, we anticipate that an entity would formally update the estimate on a regular basis (e.g., monthly, quarterly, semi-annually).

The frequency of updates should be based on the facts and circumstances of the performance obligation for which the estimate is made. An entity uses current information each time it develops or updates its estimate. While the estimates may be updated, the method used to estimate stand-alone selling price does not change (i.e., an entity must use a consistent approach), unless facts and circumstances change.

6.1.4 Additional considerations for determining the stand-alone selling price

While not explicitly stated in IFRS 15, we anticipate that a single good or service could have more than one stand-alone selling price. That is, the entity may be willing to sell goods or services at different prices to different customers. Furthermore, a vendor may use different prices in different geographies or in markets where it uses different methods to distribute its products (e.g., use of a distributor or reseller versus selling directly to the end-customer). Accordingly, a vendor may need to stratify its analysis to determine its stand-alone selling price for each class of customer.
In addition, it may be appropriate, depending on the facts and circumstances, for an entity to develop a reasonable range for its estimated stand-alone selling price, rather than a single estimate.

When an entity estimates the stand-alone selling price, the standard is clear that the entity cannot presume that a contractually stated price or a list price for a good or service is the stand-alone selling price.

**Extract from IFRS 15**

**Example 33—Allocation methodology (IFRS 15.IE164-IE166)**

An entity enters into a contract with a customer to sell Products A, B and C in exchange for CU100. The entity will satisfy the performance obligations for each of the products at different points in time. The entity regularly sells Product A separately and therefore the stand-alone selling price is directly observable. The stand-alone selling prices of Products B and C are not directly observable.

Because the stand-alone selling prices for Products B and C are not directly observable, the entity must estimate them. To estimate the stand-alone selling prices, the entity uses the adjusted market assessment approach for Product B and the expected cost plus a margin approach for Product C. In making those estimates, the entity maximises the use of observable inputs (in accordance with paragraph 78 of IFRS 15). The entity estimates the stand-alone selling prices as follows:

<table>
<thead>
<tr>
<th>Product</th>
<th>Stand-alone selling price</th>
<th>Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>50</td>
<td>Directly observable (see paragraph 77 of IFRS 15)</td>
</tr>
<tr>
<td>Product B</td>
<td>25</td>
<td>Adjusted market assessment approach (see paragraph 79(a) of IFRS 15)</td>
</tr>
<tr>
<td>Product C</td>
<td>75</td>
<td>Expected cost plus a margin approach (see paragraph 79(b) of IFRS 15)</td>
</tr>
<tr>
<td>Total</td>
<td>150</td>
<td></td>
</tr>
</tbody>
</table>

The customer receives a discount for purchasing the bundle of goods because the sum of the stand-alone selling prices (CU150) exceeds the promised consideration (CU100). The entity considers whether it has observable evidence about the performance obligation to which the entire discount belongs (in accordance with paragraph 82 of IFRS 15) and concludes that it does not. Consequently, in accordance with paragraphs 76 and 81 of IFRS 15, the discount is allocated proportionately across Products A, B and C. The discount, and therefore the transaction price, is allocated as follows:

<table>
<thead>
<tr>
<th>Product</th>
<th>Allocated transaction price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>(CU50 + CU150 × CU100)</td>
</tr>
<tr>
<td>Product B</td>
<td>(CU25 + CU150 × CU100)</td>
</tr>
<tr>
<td>Product C</td>
<td>(CU75 + CU150 × CU100)</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>
6.1.5 Measurement of options that are separate performance obligations

An entity that determines that an option is a separate performance obligation (because the option provides the customer with a material right, as discussed further in Section 4.6) needs to determine the stand-alone selling price of the option. If the option's stand-alone selling price is not directly observable, the entity estimates it, taking into consideration the discount the customer would receive in a stand-alone transaction and the likelihood that the customer would exercise the option.

IFRS 15 provides an alternative to estimating the stand-alone selling price of an option if that amount is not observable. This practical alternative applies when the goods or services are both: (1) similar to the original goods and services in the contract; and (2) provided in accordance with the terms of the original contract. The standard indicates this alternative will generally cover options for contract renewals. Under this alternative, instead of valuing the option itself, an entity may assume the option will be exercised, by including the optional additional goods and services with the performance obligations already identified in the contract and including the consideration related to the optional goods or services in the estimated transaction price.

The following example illustrates the two possible approaches for valuing options included in a contract:

<table>
<thead>
<tr>
<th>Illustration 6-1 – Accounting for an option</th>
</tr>
</thead>
<tbody>
<tr>
<td>A machinery maintenance contract provider offers a promotion to new customers who pay full price for the first year of maintenance coverage that would grant them an option to renew their services for up to two years at a discount. The entity regularly sells maintenance coverage for CU750 per year. With the promotion, the customer would be able to renew the one-year maintenance at the end of each year for CU600. The entity concludes that the ability to renew is a material right because the customer would receive a discount that exceeds any discount available to other customers. The entity also determines that no directly observable stand-alone selling price exists for the option to renew at a discount.</td>
</tr>
<tr>
<td><strong>Scenario A – Estimate the stand-alone selling price of the option</strong></td>
</tr>
<tr>
<td>Since the entity has no directly observable evidence of the stand-alone selling price for the renewal option, it estimates the stand-alone selling price of an option for a CU150 discount on the renewal of service in years two and three. When developing its estimate, the entity would consider factors such as the likelihood that the option will be exercised, the time value of the money (as the discount is only available in future periods) and the price of comparable discounted offers. For example, the entity may consider the selling price of an offer for a discounted price of similar services found on a ‘deal of the day’ website.</td>
</tr>
</tbody>
</table>
The option will then be included in the relative stand-alone selling price allocation. In this example, there will be two performance obligations: one-year of maintenance services; and an option for discounted renewals. The consideration of CU750 is allocated between these two performance obligations based on their relative stand-alone selling prices.

**Scenario B – Assume the exercise of the option**

Assume the entity chooses to evaluate the transaction assuming the customer will exercise the option. Under this alternative, the entity includes the proceeds associated with the option (assuming it is exercised) in the transaction price and includes the optional service periods in the identified performance obligations.

Assume the entity obtained 100 new customers under the promotion. Based on its experience, the entity anticipates approximately 50% attrition annually, after giving consideration to the anticipated effect of the CU150 discount. The entity concludes that it is not highly probable that a significant revenue reversal will not occur. Therefore, the entity concludes that, for this portfolio of new contracts, it will provide maintenance services for all 100 customers in the first year, 50 customers in the second year and 25 customers in the third year (a total of 175 maintenance contracts).

The total consideration the entity expects to receive is CU120,000 \[(100 \times \text{CU750}) + (50 \times \text{CU600}) + (25 \times \text{CU600})\]. Assuming the stand-alone selling price for each maintenance contract period is the same, the entity allocates CU685.71 (CU120,000 / 175) to each maintenance contract sold.

The entity would recognise revenue related to the maintenance services as the services are performed. During the first year, the entity would recognise revenue of CU68,571 (100 maintenance contracts sold x the allocated price of CU685.71 per maintenance contract) and deferred revenue of CU6,429 (CU75,000 cash received less CU68,571 revenue recognised).

If the actual renewals in years two and three differ from expectations, the entity would have to update its estimates.

**What’s changing from current IFRS?**

The requirement to identify and allocate contract consideration to an option on a relative stand-alone selling price basis will likely be a significant change in practice for many IFRS preparers.

For entities that developed their accounting policy for allocation of revenue in a multiple-element arrangement by reference to US GAAP, the requirements are generally consistent with the current requirements in ASC 605-25. However, ASC 605-25 requires the entity to estimate the selling price of the option (unless other objective evidence of the selling price exists) and does not provide the alternative method of assuming the option is exercised.
6.2 Applying the relative stand-alone selling price method

Once an entity has determined the stand-alone selling price for the separate goods and services in a contract, the entity allocates the transaction price to those performance obligations. The standard requires an entity to use the relative stand-alone selling price method to allocate the transaction price, except in the two specific circumstances (variable consideration and discounts), which are described in Sections 6.3 and 6.4 below.

Under the relative stand-alone selling price method, the transaction price is allocated to each separate performance obligation based on the proportion of the stand-alone selling price of each performance obligation to the sum of the stand-alone selling prices of all of the performance obligations in the arrangement.

What’s changing from current IFRS?

The method of allocation in IFRS 15 is not significantly different from the mechanics of applying current methods, such as a relative fair value approach. However, the methodology may be complicated when an entity applies one or both of the exceptions provided in IFRS 15 (described in Sections 6.3 and 6.4 below).

We have provided the following example of a relative stand-alone selling price allocation:

**Illustration 6-2 — Relative stand-alone selling price allocation**

Manufacturing Co. entered into a contract with a customer to sell a machine for CU100,000. The total contract price included installation of the machine and a two-year extended warranty. Assume that Manufacturing Co. determined there were three performance obligations and the stand-alone selling prices of those performance obligations were as follows: machine – CU75,000, installation services – CU14,000 and extended warranty – CU20,000.

The aggregate of the stand-alone selling prices (CU109,000) exceeds the total transaction price of CU100,000, indicating there is a discount inherent in the contract. That discount must be allocated to each of the individual performance obligations based on the relative stand-alone selling price of each performance obligation. Therefore, the amount of the CU100,000 transaction price is allocated to each performance obligation as follows:

- Machine – CU68,807 (CU75,000 x (CU100,000 / CU109,000))
- Installation – CU12,844 (CU14,000 x (CU100,000 / CU109,000))
- Warranty – CU18,349 (CU20,000 x (CU100,000 / CU109,000))

The entity would recognise as revenue the amount allocated to each performance obligation when (or as) each performance obligation is satisfied.
6.3 Allocating variable consideration

The standard provides two exceptions to the relative selling price method of allocating the transaction price.

The first relates to the allocation of variable consideration (see Section 6.4 for the second exception). This exception requires variable consideration to be allocated entirely to a specific part of a contract, such as one or more (but not all) performance obligations in the contract or one or more (but not all) distinct goods or services promised in a series of distinct goods or services that form part of a single performance obligation (see Section 4.2.2). Therefore, this exception will be applied to a single performance obligation, a combination of performance obligations or distinct goods or services that make up part of a performance obligation, depending on the facts and circumstances of each contract.

Two criteria must be met to apply this exception, as detailed in the following extract:

**Extract from IFRS 15**

84. Variable consideration that is promised in a contract may be attributable to the entire contract or to a specific part of the contract, such as either of the following:

   (a) one or more, but not all, performance obligations in the contract (for example, a bonus may be contingent on an entity transferring a promised good or service within a specified period of time); or

   (b) 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 in accordance with paragraph 22(b) (for example, the consideration promised for the second year of a two-year cleaning service contract will increase on the basis of movements in a specified inflation index).

85. An entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with paragraph 22(b) if both of the following criteria are met:

   (a) the terms of a variable payment relate specifically to the entity’s efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service); and

   (b) allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in paragraph 73 when considering all of the performance obligations and payment terms in the contract.

86. The allocation requirements in paragraphs 73–83 shall be applied to allocate the remaining amount of the transaction price that does not meet the criteria in paragraph 85.
While the language in IFRS 15.85 in the extract above implies that this exception is limited to a single performance obligation or a single distinct good or service, IFRS 15.84 indicates that the variable consideration can be allocated to “one or more, but not all, performance obligations”. We understand that the Boards chose to use a drafting convention throughout the standard to use a singular reference, rather than continuing to repeat “one or more, but not all” for the remainder of the discussion. This understanding is consistent with IFRS 15.84.

The Boards noted in the Basis for Conclusions that this exception is necessary because there may be transactions in which allocating contingent amounts to all performance obligations in a contract provides a result that does not reflect the economics of the transaction. In such situations, allocating variable consideration entirely to a distinct good or service may be appropriate when the result is that the amount allocated to that particular good or service is reasonable relative to all other performance obligations and payment terms in the contract. Subsequent changes in variable consideration must be allocated in a consistent manner.

It is important to note that allocating variable consideration to one or more, but not all, performance obligations is a requirement, not a policy election. If the above criteria are met, the entity must allocate the variable consideration to the related performance obligation(s).

The standard provides the following example to illustrate when an entity may or may not be able to allocate variable consideration to a specific part of a contract. Note, the example focuses on licences of intellectual property, which are discussed in Section 8.4:

**Extract from IFRS 15**

**Example 35 — Allocation of variable consideration (IFRS 15.IE178-IE187)**

An entity enters into a contract with a customer for two intellectual property licences (Licences X and Y), which the entity determines to represent two performance obligations each satisfied at a point in time. The stand-alone selling prices of Licences X and Y are CU800 and CU1,000, respectively.

**Case A—Variable consideration allocated entirely to one performance obligation**

The price stated in the contract for Licence X is a fixed amount of CU800 and for Licence Y the consideration is three per cent of the customer’s future sales of products that use Licence Y. For purposes of allocation, the entity estimates its sales-based royalties (ie the variable consideration) to be CU1,000, in accordance with paragraph 53 of IFRS 15.

To allocate the transaction price, the entity considers the criteria in paragraph 85 of IFRS 15 and concludes that the variable consideration (ie the sales-based royalties) should be allocated entirely to Licence Y. The entity concludes that the criteria in paragraph 85 of IFRS 15 are met for the following reasons:

(a) the variable payment relates specifically to an outcome from the performance obligation to transfer Licence Y (ie the customer’s subsequent sales of products that use Licence Y).

111 IFRS 15.BC278.
Extract from IFRS 15 (cont’d)

(b) allocating the expected royalty amounts of CU1,000 entirely to Licence Y is consistent with the allocation objective in paragraph 73 of IFRS 15. This is because the entity’s estimate of the amount of sales-based royalties (CU1,000) approximates the stand-alone selling price of Licence Y and the fixed amount of CU800 approximates the stand-alone selling price of Licence X. The entity allocates CU800 to Licence X in accordance with paragraph 86 of IFRS 15. This is because, based on an assessment of the facts and circumstances relating to both licences, allocating to Licence Y some of the fixed consideration in addition to all of the variable consideration would not meet the allocation objective in paragraph 73 of IFRS 15.

The entity transfers Licence Y at inception of the contract and transfers Licence X one month later. Upon the transfer of Licence Y, the entity does not recognise revenue because the consideration allocated to Licence Y is in the form of a sales-based royalty. Therefore, in accordance with paragraph B63 of IFRS 15, the entity recognises revenue for the sales-based royalty when those subsequent sales occur.

When Licence X is transferred, the entity recognises as revenue the CU800 allocated to Licence X.

Case B—Variable consideration allocated on the basis of stand-alone selling prices

The price stated in the contract for Licence X is a fixed amount of CU300 and for Licence Y the consideration is five per cent of the customer’s future sales of products that use Licence Y. The entity’s estimate of the sales-based royalties (i.e., the variable consideration) is CU1,500 in accordance with paragraph 53 of IFRS 15.

To allocate the transaction price, the entity applies the criteria in paragraph 85 of IFRS 15 to determine whether to allocate the variable consideration (i.e., the sales-based royalties) entirely to Licence Y. In applying the criteria, the entity concludes that even though the variable payments relate specifically to an outcome from the performance obligation to transfer Licence Y (i.e., the customer’s subsequent sales of products that use Licence Y), allocating the variable consideration entirely to Licence Y would be inconsistent with the principle for allocating the transaction price. Allocating CU300 to Licence X and CU1,500 to Licence Y does not reflect a reasonable allocation of the transaction price on the basis of the stand-alone selling prices of Licences X and Y of CU800 and CU1,000, respectively. Consequently, the entity applies the general allocation requirements in paragraphs 76–80 of IFRS 15.

The entity allocates the transaction price of CU300 to Licences X and Y on the basis of relative stand-alone selling prices of CU800 and CU1,000, respectively. The entity also allocates the consideration related to the sales-based royalty on a relative stand-alone selling price basis. However, in accordance with paragraph B63 of IFRS 15, when an entity licenses intellectual property in which the consideration is in the form of a sales-based royalty, the entity cannot recognise revenue until the later of the following events: the subsequent sales occur or the performance obligation is satisfied (or partially satisfied).
Extract from IFRS 15 (cont’d)

Licence Y is transferred to the customer at the inception of the contract and Licence X is transferred three months later. When Licence Y is transferred, the entity recognises as revenue the CU167 (CU1,000 ÷ CU1,800 × CU300) allocated to Licence Y. When Licence X is transferred, the entity recognises as revenue the CU133 (CU800 ÷ CU1,800 × CU300) allocated to Licence X.

In the first month, the royalty due from the customer’s first month of sales is CU200. Consequently, in accordance with paragraph B63 of IFRS 15, the entity recognises as revenue the CU111 (CU1,000 ÷ CU1,800 × CU200) allocated to Licence Y (which has been transferred to the customer and is therefore a satisfied performance obligation). The entity recognises a contract liability for the CU89 (CU800 ÷ CU1,800 × CU200) allocated to Licence X. This is because although the subsequent sale by the entity’s customer has occurred, the performance obligation to which the royalty has been allocated has not been satisfied.

Summary of recent TRG discussions

Applying the variable consideration allocation exception to a series of distinct goods or services

TRG members’ discussions in July 2015 highlighted that some stakeholders thought the allocation of variable consideration to a distinct good or service in a series was required to be on a relative stand-alone selling price basis. Using that basis could limit the number of transactions that qualify for the allocation exception. That is, requiring a relative stand-alone selling price basis might imply that each distinct good or service that is substantially the same would need to be allocated the same amount (absolute value) of variable consideration.

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 to IFRS 15 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).112

6.4 Allocating a discount

Another exception to the relative stand-alone selling price allocation (see Section 6.3 for the first exception) relates to discounts inherent in a contract. When an entity sells a bundle of goods and services, the selling price of the bundle is often less than the sum of the stand-alone selling prices of the individual elements. Under the relative stand-alone selling price allocation method, this discount would be allocated proportionately to all of the separate performance obligations.

However, the standard states that if an entity determines that a discount in a contract is not related to all of the promised goods or services in the contract, the entity only allocates the discount to the goods or services to which it relates. An entity would make this determination when the price of certain goods or services is largely independent of other goods or services in the contract. In these situations, an entity would be able to effectively ‘carve out’ an individual

112 IFRS 15.BC279-BC280
performance obligation, or some of the performance obligations in the contract, and allocate the discount to that performance obligation or group of performance obligations. The standard states the following:

**Extract from IFRS 15**

82. An entity shall allocate a discount entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:

(a) the entity regularly sells each distinct good or service (or each bundle of distinct goods or services) in the contract on a stand-alone basis;

(b) the entity also regularly sells on a stand-alone basis a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle; and

(c) the discount attributable to each bundle of goods or services described in paragraph 82(b) is substantially the same as the discount in the contract and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation (or performance obligations) to which the entire discount in the contract belongs.

While the standard contemplates that an entity may allocate a discount to as few as one performance obligation, the Boards make clear, in the Basis for Conclusions, that they believe such a situation would be rare. Instead, the Boards believe it is more likely that an entity will be able to demonstrate that a discount relates to two or more performance obligations. This is because an entity will likely have observable information that supports the stand-alone selling price of a group of promised goods or services being lower than the pricing of those items when sold separately. It would probably be more difficult for an entity to have sufficient evidence to demonstrate that a discount is associated with a single performance obligation.

The standard includes the following example to illustrate this concept:

**Extract from IFRS 15**

**Example 34 – Allocating a discount (IFRS 15.IE167-IE177)**

An entity regularly sells Products A, B and C individually, thereby establishing the following stand-alone selling prices:

<table>
<thead>
<tr>
<th>Product</th>
<th>Stand-alone setting price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>40</td>
</tr>
<tr>
<td>Product B</td>
<td>55</td>
</tr>
<tr>
<td>Product C</td>
<td>45</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>140</strong></td>
</tr>
</tbody>
</table>

In addition, the entity regularly sells Products B and C together for CU60.

**Case A—Allocating a discount to one or more performance obligations**

The entity enters into a contract with a customer to sell Products A, B and C in exchange for CU100. The entity will satisfy the performance obligations for each of the products at different points in time.

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113 IFRS 15.BC283
The contract includes a discount of CU40 on the overall transaction, which would be allocated proportionately to all three performance obligations when allocating the transaction price using the relative stand-alone selling price method (in accordance with paragraph 81 of IFRS 15). However, because the entity regularly sells Products B and C together for CU60 and Product A for CU40, it has evidence that the entire discount should be allocated to the promises to transfer Products B and C in accordance with paragraph 82 of IFRS 15.

If the entity transfers control of Products B and C at the same point in time, then the entity could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, the entity could allocate CU60 of the transaction price to the single performance obligation and recognise revenue of CU60 when Products B and C simultaneously transfer to the customer.

If the contract requires the entity to transfer control of Products B and C at different points in time, then the allocated amount of CU60 is individually allocated to the promises to transfer Product B (stand-alone selling price of CU55) and Product C (stand-alone selling price of CU45) as follows:

<table>
<thead>
<tr>
<th>Product</th>
<th>Allocated transaction price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product B</td>
<td>33 (CU55 ÷ CU100 total stand-alone selling price × CU60)</td>
</tr>
<tr>
<td>Product C</td>
<td>27 (CU45 ÷ CU100 total stand-alone selling price × CU60)</td>
</tr>
<tr>
<td>Total</td>
<td>60</td>
</tr>
</tbody>
</table>

**Case B—Residual approach is appropriate**

The entity enters into a contract with a customer to sell Products A, B and C as described in Case A. The contract also includes a promise to transfer Product D. Total consideration in the contract is CU130. The stand-alone selling price for Product D is highly variable (see paragraph 79(c) of IFRS 15) because the entity sells Product D to different customers for a broad range of amounts (CU15-CU45). Consequently, the entity decides to estimate the stand-alone selling price of Product D using the residual approach.

Before estimating the stand-alone selling price of Product D using the residual approach, the entity determines whether any discount should be allocated to the other performance obligations in the contract in accordance with paragraphs 82 and 83 of IFRS 15.

As in Case A, because the entity regularly sells Products B and C together for CU60 and Product A for CU40, it has observable evidence that CU100 should be allocated to those three products and a CU40 discount should be allocated to the promises to transfer Products B and C in accordance with paragraph 82 of IFRS 15. Using the residual approach, the entity estimates the stand-alone selling price of Product D to be CU30 as follows:
Extract from IFRS 15 (cont’d)

<table>
<thead>
<tr>
<th>Product</th>
<th>Stand-alone selling price</th>
<th>Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>40</td>
<td>Directly observable (see paragraph 77 of IFRS 15)</td>
</tr>
<tr>
<td>Products B</td>
<td>60</td>
<td>Directly observable with discount (see paragraph 82 of IFRS 15)</td>
</tr>
<tr>
<td>and C</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product D</td>
<td>30</td>
<td>Residual approach (see paragraph 79(c) of IFRS 15)</td>
</tr>
<tr>
<td>Total</td>
<td>130</td>
<td></td>
</tr>
</tbody>
</table>

The entity observes that the resulting CU30 allocated to Product D is within the range of its observable selling prices (CU15-CU45). Therefore, the resulting allocation (see above table) is consistent with the allocation objective in paragraph 73 of IFRS 15 and the requirements in paragraph 78 of IFRS 15.

Case C—Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is CU105 instead of CU130. Consequently, the application of the residual approach would result in a stand-alone selling price of CU5 for Product D (CU105 transaction price less CU100 allocated to Products A, B and C). The entity concludes that CU5 would not faithfully depict the amount of consideration to which the entity expects to be entitled in exchange for satisfying its performance obligation to transfer Product D, because CU5 does not approximate the stand-alone selling price of Product D, which ranges from CU15-CU45. Consequently, the entity reviews its observable data, including sales and margin reports, to estimate the stand-alone selling price of Product D using another suitable method. The entity allocates the transaction price of CU130 to Products A, B, C and D using the relative stand-alone selling prices of those products in accordance with paragraphs 73-80 of IFRS 15.

As illustrated by the example above, this exception also allows only a portion of the total discount within a contract to be allocated directly to a bundle of some, but not all, of the elements within the contract. That is, in Scenario B outlined above, some of the discount inherent in the contract is allocated to Products B and C based on the discounted price at which that bundle is regularly sold. Any remaining discount in the contract is allocated to Product D, based on the residual approach.

What’s changing from current IFRS?

The ability to allocate a discount to some, but not all, performance obligations within a contract is a significant change from current practice. This exception gives entities the ability to better reflect the economics of the transaction in certain circumstances. However, the criteria that must be met to demonstrate that a discount is associated with only some of the performance obligations in the contract will likely limit the number of transactions that will be eligible for this exception.
**Summary of recent TRG discussions**

*Interaction between the two allocation exceptions: variable discounts*

A discount that is variable in amount and/or contingent on the occurrence or non-occurrence of future events will also meet the definition of variable consideration (see Section 5.1 above). As a result, some stakeholders have questioned which exception would apply – allocating a discount or allocating variable consideration.

At the March 2015 TRG meeting, members of the TRG generally agreed that an entity will first determine whether a variable discount meets the variable consideration exception (see Section 6.3 above).114 If it does not, the entity will then consider whether it meets the discount exception.

Members of the TRG also noted that, 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.

### 6.5 Changes in transaction price after contract inception

Changes in the total transaction price are allocated to the separate performance obligations on the same basis as the initial allocation, whether they are allocated based on the relative selling price (i.e., using the same proportionate share of the total) or to individual performance obligations as discussed above. As discussed in Section 6.1, stand-alone selling prices are not updated after contract inception.

However, if the contract is modified, the contract modification requirements in IFRS 15.18-21 must be followed. Depending on the facts and circumstances, this could result in a need to update the stand-alone selling prices. See Section 3.3 for a discussion on contract modifications. Changes in transaction price resulting from the modification would also be subject to those requirements.

However, when contracts include variable consideration, it is possible that changes in the transaction price that arise after the modification may (or may not) be related to performance obligations that existed before the modification. For changes in the transaction price arising after a contract modification, when the contract modification was not treated as a separate contract, an entity must apply one of the following approaches:

- If the change in transaction price is attributable to an amount of variable consideration promised before the modification and the modification was considered a termination of the existing contract and the creation of a new contract, the entity allocates the change in transaction price to the performance obligations that existed before the modification.

- In all other cases, the change in the transaction price is allocated to the performance obligations in the modified contract (i.e., the performance obligations that were unsatisfied and partially unsatisfied immediately after the modification).

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114 IFRS 15.86
6.6 Allocation of transaction price to components outside the scope of IFRS 15

Contracts to sell goods or services frequently contain multiple elements, including some components that are not in the scope of IFRS 15. As discussed further in Section 2.3, the standard indicates that in such situations, an entity must first apply the other standards if those standards address separation and/or measurement.

For example, some standards require certain components, such as derivatives, to be accounted for at fair value. As a result, when a revenue contract includes that type of component, the fair value of that component must be separated from the total transaction price. The remaining transaction price is then allocated to the remaining performance obligations. The following example illustrates this concept:

**Illustration 6-3 — Arrangements with components that must be accounted for at fair value**

Company A, an oil producer, agrees to sell 1,200 barrels of crude oil to Customer B and immediately delivers it. As part of the agreement, Company A also writes an option for Company B to purchase an additional 1,000 barrels of crude oil in six months. The option is accounted for as a derivative within the scope of IAS 39 (assume for the purposes of this illustration that the own use criteria are not met).

The total transaction price is CU50,000. The stand-alone selling price of the delivered crude oil and the fair value of the option are CU48,000 and CU7,000, respectively.

**Analysis**

IAS 39 requires that derivatives be initially recognised and subsequently remeasured at fair value (with changes recognised in profit or loss). Therefore, a portion of the transaction price equal to the option’s fair value is allocated to the derivative. The allocation of the total transaction price is, as follows:

<table>
<thead>
<tr>
<th></th>
<th>Selling price and fair value</th>
<th>% Allocated discount</th>
<th>Allocated discount</th>
<th>Arrangement consideration allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude oil</td>
<td>CU 48,000</td>
<td>100%</td>
<td>CU 5,000</td>
<td>CU 43,000</td>
</tr>
<tr>
<td>Option</td>
<td>7,000</td>
<td>0%</td>
<td>-</td>
<td>7,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>CU 55,000</strong></td>
<td><strong>CU 5,000</strong></td>
<td><strong>CU 50,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

For components that must be recognised at fair value at inception, any subsequent remeasurement would be pursuant to other IFRSs (e.g., IFRS 9 or IAS 39). That is, subsequent adjustments to the fair value of those components have no effect on the amount of the transaction price previously allocated to any performance obligations included in the contract or on revenue recognised.
7 Satisfaction of performance obligations

Under IFRS 15, an entity only recognises revenue when it satisfies an identified performance obligation by transferring a promised good or service to a customer. A good or service is generally considered to be transferred when the customer obtains control.

Recognising revenue upon a transfer of control is a different approach from the ‘risks and rewards’ model that currently exists in IFRS. IFRS 15 states that “control of an asset refers to the ability to direct the use of and obtain substantially all of the remaining benefits from the asset”. Control also means the ability to prevent others from directing the use of, and receiving the benefit from, a good or service.

Under IFRS 15, the transfer of control to the customer represents the transfer of the rights with regard to the good or service. The customer’s ability to receive the benefit from the good or service is represented by its right to substantially all of the cash inflows, or the reduction of the cash outflows, generated by the goods or services. Upon transfer of control, the customer has sole possession of the right to use the good or service for the remainder of its economic life or to consume the good or service in its own operations.

The standard indicates that an entity must determine, at contract inception, whether it will transfer control of a promised good or service over time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time. These concepts are explored further in the following sections.

7.1 Performance obligations satisfied over time

Frequently, entities transfer the promised goods and services to the customer over time. While the determination of whether goods or services are transferred over time is straightforward in some contracts (e.g., many service contracts), it is more difficult in other contracts. To help entities determine whether control transfers over time (rather than at a point in time), the Boards provided the following criteria:

### Extract from IFRS 15

35. 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 the following criteria is met:

(a) the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs (see paragraphs B3–B4);

(b) the entity’s performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or

(c) the entity’s performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).

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115 IFRS 15.33
Examples of each of the criteria in the extract above are included in the following sections. If an entity is unable to demonstrate that control transfers over time, the presumption is that control transfers at a point in time (see Section 7.2).

7.1.1 Customer simultaneously receives and consumes benefits as the entity performs

IFRS 15 states the following in relation to the first criterion, which is the simultaneous receipt and consumption of the benefits of the entity's performance:

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**Extract from IFRS 15**

B3. For some types of performance obligations, the assessment of whether a customer receives the benefits of an entity's performance as the entity performs and simultaneously consumes those benefits as they are received will be straightforward. Examples include routine or recurring services (such as a cleaning service) in which the receipt and simultaneous consumption by the customer of the benefits of the entity's performance can be readily identified.

B4. For other types of performance obligations, an entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In those circumstances, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date if that other entity were to fulfill the remaining performance obligation to the customer. In determining whether another entity would not need to substantially re-perform the work the entity has completed to date, an entity shall make both of the following assumptions:

(a) disregard potential contractual restrictions or practical limitations that otherwise would prevent the entity from transferring the remaining performance obligation to another entity; and

(b) presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any asset that is presently controlled by the entity and that would remain controlled by the entity if the performance obligation were to transfer to another entity.

As discussed in the Basis for Conclusions, the Boards created this criterion to clarify that in pure service contracts, entities will generally transfer services over time. The Boards note that an entity does not apply this criterion (to determine whether a performance obligation is satisfied over time) if the entity's performance creates an asset that the customer does not consume completely as the asset is received. Instead, an entity assesses that performance obligation using the criteria discussed in Sections 7.1.2 and 7.1.3.

For some service contracts, the entity's performance may not result in the recognition of an asset as the entity performs, but the customer is also not consuming the benefit of the entity's performance until the entity's performance is complete. The standard provides an example of an entity providing consulting services that will take the form of a professional opinion.

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116 See IFRS 15.BC125-BC128
upon the completion of the services. In this situation, an entity cannot conclude that the services are transferred over time based on this criterion. Instead, the entity must consider the remaining two criteria in IFRS 15.35.

### Extract from IFRS 15

**Example 13 – Customer simultaneously receives and consumes the benefits (IFRS 15.IE67-68)**

An entity enters into a contract to provide monthly payroll processing services to a customer for one year.

The promised payroll processing services are accounted for as a single performance obligation in accordance with paragraph 22(b) of IFRS 15. The performance obligation is satisfied over time in accordance with paragraph 35(a) of IFRS 15 because the customer simultaneously receives and consumes the benefits of the entity’s performance in processing each payroll transaction as and when each transaction is processed. The fact that another entity would not need to re-perform payroll processing services for the service that the entity has provided to date also demonstrates that the customer simultaneously receives and consumes the benefits of the entity’s performance as the entity performs. (The entity disregards any practical limitations on transferring the remaining performance obligation, including setup activities that would need to be undertaken by another entity.) The entity recognises revenue over time by measuring its progress towards complete satisfaction of that performance obligation in accordance with paragraphs 39–45 and B14-B19 of IFRS 15.

### Summary of recent TRG discussions

**Evaluating whether a customer simultaneously receives and consumes the benefits of a commodity as the entity performs**

In July 2015, TRG members discussed the factors that an entity should consider when evaluating whether a customer simultaneously receives and consumes the benefits of a commodity (e.g., electricity, natural gas, heating oil) as the entity performs. Whether a commodity meets this criterion and is transferred over time is important in determining whether the sale of a commodity will meet the criteria to apply the series requirement (see Section 4.2.2 above). This, in turn, affects how an entity will allocate variable consideration and apply the requirements for contract modifications and changes in the transaction price.

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

As such, revenue related to the sale of a commodity may or may not be recognised over time, depending on whether the facts and circumstances of the contract indicate that the customer will simultaneously receive and consume the benefits. This evaluation will likely require the use of significant judgement.
7.1.2 Customer controls asset as it is created or enhanced

The second criterion to determine whether control of a good or service is transferred over time is that the customer controls the asset as it is being created or enhanced. For purposes of this determination, the definition of ‘control’ is the same as previously discussed (i.e., the ability to direct the use of and obtain substantially all of the remaining benefits from the asset). Furthermore, the asset being created or enhanced can be either tangible or intangible. For example, in a contract to develop an IT system on the customer’s premises, the customer controls the system while it is being developed or enhanced and, therefore, control is transferred over time. Some construction contracts may also contain clauses indicating that the customer owns any work-in-progress as the contracted item is being built. The Boards believe the customer’s control over the asset as it is being created or enhanced indicates that the entity’s performance transfers goods or services to a customer over time.

7.1.3 Asset with no alternative use and right to payment

The last criterion to determine whether an entity transfers control of a good or service over time has the following two requirements:

- The entity’s performance does not create an asset with alternative use to the entity
- The entity has an enforceable right to payment for performance completed to date

Each of these concepts is discussed further below.

**Alternative use**

The standard imposes the following requirements for ‘alternative use’:

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**Extract from IFRS 15**

36. An asset created by an entity’s performance does not have an alternative use to an entity if the entity is either restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset or limited practically from readily directing the asset in its completed state for another use. The assessment of whether an asset has an alternative use to the entity is made at contract inception. After contract inception, an entity shall not update the assessment of the alternative use of an asset unless the parties to the contract approve a contract modification that substantively changes the performance obligation. Paragraphs B6-B8 provide guidance for assessing whether an asset has an alternative use to an entity.

...  

B6. In assessing whether an asset has an alternative use to an entity in accordance with paragraph 36, an entity shall consider the effects of contractual restrictions and practical limitations on the entity’s ability to readily direct that asset for another use, such as selling it to a different customer. The possibility of the contract with the customer being terminated is not a relevant consideration in assessing whether the entity would be able to readily direct the asset for another use.
Extract from IFRS 15 (cont’d)

B7. A contractual restriction on an entity’s ability to direct an asset for another use must be substantive for the asset not to have an alternative use to the entity. A contractual restriction is substantive if a customer could enforce its rights to the promised asset if the entity sought to direct the asset for another use. In contrast, a contractual restriction is not substantive if, for example, an asset is largely interchangeable with other assets that the entity could transfer to another customer without breaching the contract and without incurring significant costs that otherwise would not have been incurred in relation to that contract.

B8. A practical limitation on an entity’s ability to direct an asset for another use exists if an entity would incur significant economic losses to direct the asset for another use. A significant economic loss could arise because the entity either would incur significant costs to rework the asset or would only be able to sell the asset at a significant loss. For example, an entity may be practically limited from redirecting assets that either have design specifications that are unique to a customer or are located in remote areas.

The Boards concluded that, when an entity is creating something that is highly customised for a particular customer, it is less likely that the entity could use that asset for any other purpose. That is, the entity would likely need to incur significant rework costs or sell the asset at a significantly reduced price. As a result, the customer could be viewed as having control of the asset. However, in this situation, the Boards concluded it was not enough to determine that the customer effectively controls the asset. The entity would also need to determine it has an enforceable right to payment for performance to date, as is discussed below.

In making the assessment of whether a good or service has alternative use, an entity must consider any substantive contractual restrictions. A contractual restriction is substantive if an entity expects the customer to enforce its rights to the promised asset if the entity sought to direct the asset for another use. Contractual restrictions that are not substantive are not considered. It is important to note that the standard also includes a practical limitation. Therefore, an asset would not have an alternative use if the entity would incur significant economic losses to direct the asset for another use. After contract inception, an entity does not update its assessment of whether an asset has an alternative use for any subsequent changes in facts and circumstances, unless the parties approve a contract modification.

How we see it

The assessment at contract inception of whether a good or service has an alternative use will require significant judgement, taking into consideration all the facts and circumstances of the contract. An important factor to be considered is the effect of any substantive contractual restrictions and/or practical limitations on an entity’s ability to readily direct that asset for another use, such as selling it to a different customer.

117 IFRS 15.BC135-BC137
**Enforceable right to payment for performance completed to date**

When evaluating whether an entity has an enforceable right to payment for performance completed to date, the standard requires the entity to consider the terms of the contract and any laws or regulations that relate to it. The standard states that the right to payment for performance completed to date need not be for a fixed amount. However, at any time during the contract term, an entity must be entitled to an amount that at least compensates the entity for performance completed to date, even if the customer can terminate the contract for reasons other than the entity's failure to perform as promised. The Boards concluded that a customer's obligation to pay for the entity's performance is an indicator that the customer has obtained benefit from the entity's performance.\(^{118}\)

The standard states the following about an entity's right to payment for performance completed to date:

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**Extract from IFRS 15**

B9. In accordance with paragraph 37, an entity has a right to payment for performance completed to date if the entity would be entitled to an amount that at least compensates the entity for its performance completed to date in the event that the customer or another party terminates the contract for reasons other than the entity's failure to perform as promised. An amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date (for example, recovery of the costs incurred by an entity in satisfying the performance obligation plus a reasonable profit margin) rather than compensation for only the entity's potential loss of profit if the contract were to be terminated. Compensation for a reasonable profit margin need not equal the profit margin expected if the contract was fulfilled as promised, but an entity should be entitled to compensation for either of the following amounts:

(a) a proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity's performance under the contract before termination by the customer (or another party); or

(b) a reasonable return on the entity's cost of capital for similar contracts (or the entity's typical operating margin for similar contracts) if the contract-specific margin is higher than the return the entity usually generates from similar contracts.

B10. An entity's right to payment for performance completed to date need not be a present unconditional right to payment. In many cases, an entity will have an unconditional right to payment only at an agreed-upon milestone or upon complete satisfaction of the performance obligation. In assessing whether it has a right to payment for performance completed to date, an entity shall consider whether it would have an enforceable right to demand or retain payment for performance completed to date if the contract were to be terminated before completion for reasons other than the entity's failure to perform as promised.

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\(^{118}\) IFRS 15.B142
B11. In some contracts, a customer may have a right to terminate the contract only at specified times during the life of the contract or the customer might not have any right to terminate the contract. If a customer acts to terminate a contract without having the right to terminate the contract at that time (including when a customer fails to perform its obligations as promised), the contract (or other laws) might entitle the entity to continue to transfer to the customer the goods or services promised in the contract and require the customer to pay the consideration promised in exchange for those goods or services. In those circumstances, an entity has a right to payment for performance completed to date because the entity has a right to continue to perform its obligations in accordance with the contract and to require the customer to perform its obligations (which include paying the promised consideration).

Entities are required to consider any laws, legislation or legal precedent that could supplement or override the contractual terms. In addition, the standard clarifies that including a payment schedule in a contract does not, in and of itself, indicate that the entity has the right to payment for performance completed to date. The entity must examine information that may contradict the payment schedule and may represent the entity's actual right to payment for performance completed to date. As highlighted in the following illustration, payments from a customer must approximate the selling price of the goods or services transferred to date to be considered a right to payment for performance to date. A fixed payment schedule may not meet this requirement.

The standard provides the following example to illustrate the concepts described in Section 7.1.3:

**Example 14 – Assessing alternative use and right to payment (IFRS 15.IE69-IE72)**

An entity enters into a contract with a customer to provide a consulting service that results in the entity providing a professional opinion to the customer. The professional opinion relates to facts and circumstances that are specific to the customer. If the customer were to terminate the consulting contract for reasons other than the entity’s failure to perform as promised, the contract requires the customer to compensate the entity for its costs incurred plus a 15 per cent margin. The 15 per cent margin approximates the profit margin that the entity earns from similar contracts.

The entity considers the criterion in paragraph 35(a) of IFRS 15 and the requirements in paragraphs B3 and B4 of IFRS 15 to determine whether the customer simultaneously receives and consumes the benefits of the entity’s performance. If the entity were to be unable to satisfy its obligation and the customer hired another consulting firm to provide the opinion, the other consulting firm would need to substantially re-perform the work that the entity had completed to date, because the other consulting firm would not have the benefit of any work in progress performed by the entity. The nature of the professional opinion is such that the customer will receive the benefits of the entity’s performance only when the customer receives the professional opinion. Consequently, the entity concludes that the criterion in paragraph 35(a) of IFRS 15 is not met.
However, the entity's performance obligation meets the criterion in paragraph 35(c) of IFRS 15 and is a performance obligation satisfied over time because of both of the following factors:

(a) in accordance with paragraphs 36 and B6-B8 of IFRS 15, the development of the professional opinion does not create an asset with alternative use to the entity because the professional opinion relates to facts and circumstances that are specific to the customer. Therefore, there is a practical limitation on the entity's ability to readily direct the asset to another customer.

(b) in accordance with paragraphs 37 and B9-B13 of IFRS 15, the entity has an enforceable right to payment for its performance completed to date for its costs plus a reasonable margin, which approximates the profit margin in other contracts.

Consequently, the entity recognises revenue over time by measuring the progress towards complete satisfaction of the performance obligation in accordance with paragraphs 39-45 and B14-B19 of IFRS 15.

7.1.4 Measuring progress

When an entity has determined that a performance obligation is satisfied over time, the standard requires the entity to select a single revenue recognition method for the relevant performance obligation that best depicts the entity's performance in transferring the goods or services. The standard provides the following requirements:

39. For each performance obligation satisfied over time in accordance with paragraphs 35-37, an entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation. The objective when measuring progress is to depict an entity’s performance in transferring control of goods or services promised to a customer (ie the satisfaction of an entity’s performance obligation).

40. An entity shall apply a single method of measuring progress for each performance obligation satisfied over time and the entity shall apply that method consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, an entity shall remeasure its progress towards complete satisfaction of a performance obligation satisfied over time.

Methods for measuring progress

41. Appropriate methods of measuring progress include output methods and input methods. Paragraphs B14-B19 provide guidance for using output methods and input methods to measure an entity’s progress towards complete satisfaction of a performance obligation. In determining the appropriate method for measuring progress, an entity shall consider the nature of the good or service that the entity promised to transfer to the customer.

42. When applying a method for measuring progress, an entity shall exclude from the measure of progress any goods or services for which the entity does not transfer control to a customer. Conversely, an entity shall include in the measure of progress any goods or services for which the entity does transfer control to a customer when satisfying that performance obligation.
Extract from IFRS 15 (cont’d)

43. As circumstances change over time, an entity shall update its measure of progress to reflect any changes in the outcome of the performance obligation. Such changes to an entity’s measure of progress shall be accounted for as a change in accounting estimate in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

The standard provides two methods for recognising revenue on contracts involving the transfer of goods and services over time: input and output.

While the standard requires an entity to continuously update its estimates related to the measure of progress selected, it does not permit a change in method. A performance obligation is accounted for using the method the entity selects (i.e., either the input or output method) from inception until it has been fully satisfied. It would not be appropriate for an entity to start recognising revenue based on an input measure and later switch to an output measure.

The standard contains the following application guidance on the methods:

Extract from IFRS 15

Output methods

B15. Output methods recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones reached, time elapsed and units produced or units delivered. When an entity evaluates whether to apply an output method to measure its progress, the entity shall consider whether the output selected would faithfully depict the entity’s performance towards complete satisfaction of the performance obligation. An output method would not provide a faithful depiction of the entity’s performance if the output selected would fail to measure some of the goods or services for which control has transferred to the customer. For example, output methods based on units produced or units delivered would not faithfully depict an entity’s performance in satisfying a performance obligation if, at the end of the reporting period, the entity’s performance has produced work in progress or finished goods controlled by the customer that are not included in the measurement of the output.

B16. As a practical expedient, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity’s performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognise revenue in the amount to which the entity has a right to invoice.

B17. The disadvantages of output methods are that the outputs used to measure progress may not be directly observable and the information required to apply them may not be available to an entity without undue cost. Therefore, an input method may be necessary.
Input methods

B18. Input methods recognise revenue on the basis of the entity’s efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation. If the entity’s efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognise revenue on a straight-line basis.

B19. A shortcoming of input methods is that there may not be a direct relationship between an entity’s inputs and the transfer of control of goods or services to a customer. Therefore, an entity shall exclude from an input method the effects of any inputs that, in accordance with the objective of measuring progress in paragraph 39, do not depict the entity’s performance in transferring control of goods or services to the customer. For instance, when using a cost-based input method, an adjustment to the measure of progress may be required in the following circumstances:

(a) When a cost incurred does not contribute to an entity’s progress in satisfying the performance obligation. For example, an entity would not recognise revenue on the basis of costs incurred that are attributable to significant inefficiencies in the entity’s performance that were not reflected in the price of the contract (for example, the costs of unexpected amounts of wasted materials, labour or other resources that were incurred to satisfy the performance obligation).

(b) When a cost incurred is not proportionate to the entity’s progress in satisfying the performance obligation. In those circumstances, the best depiction of the entity’s performance may be to adjust the input method to recognise revenue only to the extent of that cost incurred. For example, a faithful depiction of an entity’s performance might be to recognise revenue at an amount equal to the cost of a good used to satisfy a performance obligation if the entity expects at contract inception that all of the following conditions would be met:

(i) the good is not distinct;
(ii) the customer is expected to obtain control of the good significantly before receiving services related to the good;
(iii) the cost of the transferred good is significant relative to the total expected costs to completely satisfy the performance obligation; and
(iv) the entity procures the good from a third party and is not significantly involved in designing and manufacturing the good (but the entity is acting as a principal in accordance with paragraphs B34–B38).

While the standard does not indicate a preference for either method, it does require that the selected method be applied to similar arrangements in similar circumstances. Regardless of which method an entity selects, it excludes from its measure of progress any goods or services for which control has not transferred.
In determining the best method for measuring progress, an entity needs to consider both the nature of the promised goods or services and the nature of the entity’s performance. To illustrate this concept, the Basis for Conclusions cites a contract for health club services.\(^{119}\) Regardless of when, or how frequently, the customer uses the health club, the entity’s obligation to stand ready for the contractual period does not change.

The standard does not list passage of time as a separate method of measuring progress. However, the Boards specifically included ‘time lapsed’ as an example of an input measure that an entity may use.

The Boards provided a practical expedient for an entity that 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. For example, a service contract in which an entity bills a fixed amount for each hour of service provided. The practical expedient allows an entity to recognise revenue at the amount for which it has the right to invoice. (See below for further discussion of the ‘right to invoice’ practical expedient).

If an entity does not have a reasonable basis to measure its progress, the Boards decided that too much uncertainty exists and, therefore, revenue is not recognised until progress can be measured. An entity may be able to determine that a loss will not be incurred, but is not able to reasonably estimate the amount of profit. Until it is able to reasonably measure the outcome, the standard requires the entity to recognise revenue, but only up to the amount of the costs incurred.

**Illustration 7-1 – Choosing the measure of progress**

A ship building entity enters into a contract to build 15 vessels for a customer over a three-year period. The customer played a significant role in the design of the vessels and the entity has not built a vessel of this nature in the past. As a result, the contract includes both design and production services. In addition, the entity expects that the first vessels may take longer to produce than the last vessels because, as the entity gains experience building the vessels, it expects to be able to construct the vessels more efficiently.

Assume that the entity has determined that the design and production services represent a single performance obligation. In such situations, it is likely that the entity would not choose a ‘units-of-delivery’ method as a measure of progress because that method would not accurately capture the level of performance. That is, such a method would not reflect the entity’s efforts during the design phase of the contract because no revenue would be recognised until a vessel was shipped. In such situations, an entity would likely determine that an input method is more appropriate, such as a percentage of completion method based on costs incurred.

\(^{119}\) IFRS 15.BC160
The Boards stated, in the Basis for Conclusions, that a units-of-delivery or units-of-production method may not be appropriate if the contract provides both design and production services because each item produced “may not transfer an equal amount of value to the customer”. That is, the items produced earlier will likely have a higher value than those that are produced later. However, the Boards indicated that units of delivery may be an appropriate approach for certain long-term manufacturing contracts of standard items that individually transfer an equal amount of value to the customer.

<table>
<thead>
<tr>
<th>Summary of recent TRG discussions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Measuring progress toward satisfaction of a stand-ready obligation that is satisfied over time</strong></td>
</tr>
<tr>
<td>As discussed in the summary of recent TRG discussions within Section 4.1.1 above, at the January 2015 TRG meeting, members of the TRG 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. TRG members also discussed questions raised regarding how an entity would measure progress for a stand-ready obligation that is a performance obligation satisfied over time.</td>
</tr>
<tr>
<td>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).</td>
</tr>
<tr>
<td><strong>Selecting a measure of progress when there is more than one promised good or service within a performance obligation</strong></td>
</tr>
<tr>
<td>As discussed above, selecting an appropriate measure of progress may require judgement, particularly when a performance obligation includes more than one promised good or service (e.g., multiple non-distinct goods or services and/or distinct goods or services that are required to be combined with non-distinct goods or services in order to identify a distinct bundle – a combined performance obligation). In some cases, the promised goods or services in the performance obligation may transfer concurrently and the same measure of progress may be appropriate. In other cases, the promised goods or services may transfer at different times during the same period or over different periods. If the promised goods or services were separate performance obligations, an entity may have chosen different measures of progress, but since they are within one performance obligation, questions were raised regarding how an entity would select its measure of progress.</td>
</tr>
<tr>
<td>In July 2015, members of the TRG were asked to consider whether an entity can use more than one measure of progress in order 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. 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</td>
</tr>
</tbody>
</table>

\[120\] IFRS 15.BC166
### Summary of recent TRG discussions (cont’d)

Measure of progress that best depicts the entity's performance in transferring the goods or services. See below for considerations when selecting a single measure for combined performance obligations.

While TRG members did not specifically discuss this point, the agenda paper\(^{121}\) noted that in light of the discussion in the Basis for Conclusions to the standards, 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.\(^{122}\) 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 separate performance obligations.

**Determining the appropriate single measure of progress for a combined performance obligation that is satisfied over time**

As discussed above, at the July 2015 TRG meeting, TRG members agreed that an entity must select a single measure of progress for a performance obligation comprised of two or more goods and/or services that is satisfied over time. The TRG also discussed how an entity would select the most appropriate measure of progress for a combined performance obligation.

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 was 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. As such, the entity would not contemplate the transfer of that good or service when determining the pattern of revenue recognition for the combined performance obligation.

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

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\(^{121}\) TRG Agenda paper 41, *Measuring progress when multiple goods or services are included in a single performance obligation*, dated 13 July 2015

\(^{122}\) IFRS 15.BC161
Use of the ‘right to invoice’ practical expedient for a contract that includes rates that change over the contractual term

As discussed above, the right to invoice practical expedient allows an entity to recognise revenue in the amount to which it has a right to invoice if it has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity’s performance completed to date (e.g., a service contract in which an entity bills a fixed amount for each hour of service provided). Some have questioned how to evaluate whether an entity’s right to consideration from a customer corresponds directly with the value to the customer. These questions have typically arisen from fact patterns in which an entity may bill different prices for units transferred to the customer over the course of the contract term. Members of the TRG were asked, at the July 2015 TRG meeting, to consider whether the right to invoice practical expedient could apply in those circumstances.

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 in rates correspond directly to changes in value to the customer. That is, a contract does not need to have a fixed price per unit for the duration of a contract in order to qualify for the practical expedient. Examples of contracts that might qualify include an IT outsourcing arrangement with rates that decrease over the contract term as the level of effort to the customer decreases or a multi-year electricity contract that contemplates the forward market price of electricity. However, the SEC Observer also 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 agenda paper on this question also stated that the presence of an agreed-upon customer payment schedule does not mean that the amount an entity has the right to invoice corresponds directly with the value to the customer of the entity’s performance completed to date. In addition, the agenda paper stated that the existence of specified contract minimums (or volume discounts) would not always preclude the application of the practical expedient, provided that these clauses are deemed non-substantive (e.g., the entity expects to receive amounts in excess of the specified minimums)."
### Summary of recent TRG discussions (cont’d)

#### Use of the ‘backlog’ practical expedient when the criteria to use the ‘right to invoice’ practical expedient are not met

IFRS 15.120 requires an entity to disclose specified information about its remaining performance obligations (discussed further in Section 9.3.1 below), including the aggregate amount of the transaction price allocated to unsatisfied performance obligations and an explanation (quantitative or qualitative) of when the entity expects to recognise that amount disclosed. However, IFRS 15 also provides a practical expedient (the ‘backlog’ practical expedient), such that an entity is not required to disclose this information if either:

- The performance obligation is part of a contract that is one year or less
- The entity meets the requirements to apply the right to invoice practical expedient (see above)\(^{125}\)

Stakeholders have questioned whether an entity can still use the backlog practical expedient if it determines that it has not met the criteria to use the right to invoice practical expedient (e.g., because there is a substantive contractual minimum payment or a volume discount).

At the July 2015 TRG meeting, members of the TRG generally agreed that the standards are clear that an entity can only use the backlog practical expedient for contracts that meet one of the two criteria above. If a contract does not meet either of these criteria, an entity will be required to make the backlog disclosures required by IFRS 15.120. However, under these requirements, an entity is able to qualitatively describe any consideration that is not included in the transaction price (e.g., any estimated amount of variable consideration that is constrained).

#### Recognising revenue when fulfilment costs are incurred prior to the contract establishment date for a specifically anticipated contract

An entity cannot begin to recognise revenue on a contract until it meets all five criteria to be considered a contract under IFRS 15 (as discussed in Section 3.1 above), regardless of whether it has received any consideration or has begun performing under the terms of the arrangement.

Entities sometimes will begin activities on a specifically anticipated contract either:

- Before agreeing to the contract with the customer
- Before the contract satisfies the criteria to be accounted for under IFRS 15 (contract establishment date)

In relation to situations in which these activities will result in the transfer of a good or service to the customer at the contract establishment date, constituents questioned how revenue for those activities should be recognised at the contract establishment date. Members of the TRG were asked to consider this issue at the March 2015 TRG meeting. See Section 8.3.2 below for a summary of the recent TRG’s discussion regarding contract fulfilment costs incurred prior to the contract establishment date.

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125 IFRS 15.121
TRG members generally agreed that if the goods or services that ultimately will be transferred meet the criteria to be recognised over time, revenue would be recognised on a cumulative catch-up basis at the contract establishment date, reflecting the performance obligation(s) that are partially or fully satisfied at that time. The 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.

7.1.5 Adjustments to the measure of progress based on an input method

When an entity applies an input method that uses costs incurred to measure its progress towards completion, the cost incurred may not always be proportionate to the entity’s progress in satisfying the performance obligation. For example, in a performance obligation comprised of goods and services, the customer may obtain control of the goods before the entity provides the services related to those goods (e.g., goods are delivered to a customer site, but the entity has not yet integrated the goods into the overall project). The Boards concluded that, if an entity were using a percentage-of-completion method based on costs incurred to measure its progress, it may be inappropriately affected by the delivery of these goods and that a pure application of such a measure of progress would result in overstated revenue.

The standard indicates that, in such circumstances, there may be a better way to measure progress toward completion of a performance obligation. The standard provides an example of recognising revenue at an amount equal to the cost of the goods used, rather than cost incurred. The standard specifies that, in order to recognise revenue in these situations, the conditions in IFRS 15.B19(b) must be met (see the extract in Section 7.1.4).

In addition, situations may arise in which not all of the costs incurred contribute to the entity’s progress in completing the performance obligation. Under an input method, an entity excludes these types of costs (e.g., costs related to significant inefficiencies, wasted materials, required rework) from the measure of progress, unless such costs were reflected in the price of the contract.

**Example 19 – Uninstalled materials (IFRS 15.IE95-IE100)**

In November 20X2, an entity contracts with a customer to refurbish a 3-storey building and install new elevators for total consideration of CU5 million. The promised refurbishment service, including the installation of elevators, is a single performance obligation satisfied over time. Total expected costs are CU4 million, including CU1.5 million for the elevators. The entity determines that it acts as a principal in accordance with paragraphs B34–B38 of IFRS 15, because it obtains control of the elevators before they are transferred to the customer.

A summary of the transaction price and expected costs is as follows:

<table>
<thead>
<tr>
<th></th>
<th>CU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction price</td>
<td>5,000,000</td>
</tr>
<tr>
<td>Expected costs</td>
<td></td>
</tr>
<tr>
<td>Elevators</td>
<td>1,500,000</td>
</tr>
<tr>
<td>Other costs</td>
<td>2,500,000</td>
</tr>
<tr>
<td>Total expected costs</td>
<td>4,000,000</td>
</tr>
</tbody>
</table>
The entity uses an input method based on costs incurred to measure its progress towards complete satisfaction of the performance obligation. The entity assesses whether the costs incurred to procure the elevators are proportionate to the entity’s progress in satisfying the performance obligation, in accordance with paragraph B19 of IFRS 15. The customer obtains control of the elevators when they are delivered to the site in December 20X2, although the elevators will not be installed until June 20X3. The costs to procure the elevators (CU1.5 million) are significant relative to the total expected costs to completely satisfy the performance obligation (CU4 million). The entity is not involved in designing or manufacturing the elevators.

The entity concludes that including the costs to procure the elevators in the measure of progress would overstate the extent of the entity’s performance. Consequently, in accordance with paragraph B19 of IFRS 15, the entity adjusts its measure of progress to exclude the costs to procure the elevators from the measure of costs incurred and from the transaction price. The entity recognises revenue for the transfer of the elevators in an amount equal to the costs to procure the elevators (ie at a zero margin).

As of 31 December 20X2 the entity observes that:

(a) other costs incurred (excluding elevators) are CU500,000; and

(b) performance is 20 per cent complete (ie CU500,000 ÷ CU2,500,000).

Consequently, at 31 December 20X2, the entity recognises the following:

<table>
<thead>
<tr>
<th>CU</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>2,200,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>2,000,000</td>
</tr>
<tr>
<td>Profit</td>
<td>200,000</td>
</tr>
</tbody>
</table>

(a) Revenue recognised is calculated as (20 per cent × CU3,500,000) + CU1,500,000.
(CU3,500,000 is CU5,000,000 transaction price – CU1,500,000 costs of elevators.)
(b) Cost of goods sold is CU500,000 of costs incurred + CU1,500,000 costs of elevators.

IFRS 15 does not dictate which approach an entity should use in these situations. However, it is clear that an entity cannot use an input method based on costs incurred to measure progress when costs are disproportionate to the entity’s progress throughout the life of the contract. Not using a percentage of completion method (in which costs incurred are used to measure the stage of completion) in these situations may represent a significant change for some entities.

**What’s changing from current IFRS?**

The requirements for uninstalled materials may be a significant change from current practice for some entities. IAS 11 contains a requirement that when the stage of completion is determined by reference to the contract costs incurred to date, only those contract costs that reflect work performed are included.¹²⁶ Hence, costs related to future activities, such as costs of materials (that do not have a high specificity to the contract) delivered to a contract site or set aside for use in a contract, but not yet installed, would not form part of the assessment of costs incurred to date. When installed, these would be included in the costs.

¹²⁶ IAS 11.31
incurred to date. Under the new standard, any margin related to the uninstalled materials would be shifted to the other goods and services and recognised as the costs for those goods and services are incurred.

7.2 Control transferred at a point in time

For performance obligations in which control is not transferred over time, control is transferred as at a point in time. In many situations, the determination of when that point in time occurs is relatively straightforward. However, in other circumstances, this determination is more complex. To help entities determine the point in time when a customer obtains control of a particular good or service, the Boards provided the following requirements:

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**Extract from IFRS 15**

38. If a performance obligation is not satisfied over time in accordance with paragraphs 35–37, an entity satisfies the performance obligation at a point in time. To determine the point in time at which a customer obtains control of a promised asset and the entity satisfies a performance obligation, the entity shall consider the requirements for control in paragraphs 31–34. In addition, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:

(a) The entity has a present right to payment for the asset—if a customer is presently obliged to pay for an asset, then that may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset in exchange.

(b) The customer has legal title to the asset—legal title may indicate which party to a contract has the ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset or to restrict the access of other entities to those benefits. Therefore, the transfer of legal title of an asset may indicate that the customer has obtained control of the asset. If an entity retains legal title solely as protection against the customer’s failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset.

(c) The entity has transferred physical possession of the asset—the customer’s physical possession of an asset may indicate that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset or to restrict the access of other entities to those benefits. However, physical possession may not coincide with control of an asset. For example, in some repurchase agreements and in some consignment arrangements, a customer or consignee may have physical possession of an asset that the entity controls. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of an asset that the customer controls. Paragraphs B64–B76, B77–B78 and B79–B82 provide guidance on accounting for repurchase agreements, consignment arrangements and bill-and-hold arrangements, respectively.
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Extract from IFRS 15 (cont’d)

(d) The customer has the significant risks and rewards of ownership of the asset—the transfer of the significant risks and rewards of ownership of an asset to the customer may indicate that the customer has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. However, when evaluating the risks and rewards of ownership of a promised asset, an entity shall exclude any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset. For example, an entity may have transferred control of an asset to a customer but not yet satisfied an additional performance obligation to provide maintenance services related to the transferred asset.

(e) The customer has accepted the asset—the customer’s acceptance of an asset may indicate that it has obtained the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. To evaluate the effect of a contractual customer acceptance clause on when control of an asset is transferred, an entity shall consider the guidance in paragraphs B83–B86.

None of the indicators above are meant to individually determine whether the customer has gained control of the good or service. An entity must consider all relevant facts and circumstances to determine whether control has transferred. The Boards also made it clear that the indicators are not meant to be a checklist. Furthermore, not all of them must be present for an entity to determine that the customer has gained control. Rather, the indicators are factors that are often present when a customer has obtained control of an asset and the list is meant to help entities apply the principle of control.

The standard includes the following example to illustrate revenue recognition over time (see Section 7.1) and at a point in time (see Section 7.2):

Extract from IFRS 15

Example 17 – Assessing whether a performance obligation is satisfied at a point in time or over time (IFRS 15.IE81–IE90)

An entity is developing a multi-unit residential complex. A customer enters into a binding sales contract with the entity for a specified unit that is under construction. Each unit has a similar floor plan and is of a similar size, but other attributes of the units are different (for example, the location of the unit within the complex).

Case A—Entity does not have an enforceable right to payment for performance completed to date

The customer pays a deposit upon entering into the contract and the deposit is refundable only if the entity fails to complete construction of the unit in accordance with the contract. The remainder of the contract price is payable on completion of the contract when the customer obtains physical possession of the unit. If the customer defaults on the contract before completion of the unit, the entity only has the right to retain the deposit.

At contract inception, the entity applies paragraph 35(c) of IFRS 15 to determine whether its promise to construct and transfer the unit to the customer is a performance obligation satisfied over time. The entity determines that it does not have an enforceable right to payment for performance completed to date because, until construction of the unit is complete, the entity only has a right to the deposit paid by the customer.
Because the entity does not have a right to payment for work completed to date, the entity’s performance obligation is not a performance obligation satisfied over time in accordance with paragraph 35(c) of IFRS 15. Instead, the entity accounts for the sale of the unit as a performance obligation satisfied at a point in time in accordance with paragraph 38 of IFRS 15.

Case B—Entity has an enforceable right to payment for performance completed to date

The customer pays a non-refundable deposit upon entering into the contract and will make progress payments during construction of the unit. The contract has substantive terms that preclude the entity from being able to direct the unit to another customer. In addition, the customer does not have the right to terminate the contract unless the entity fails to perform as promised. If the customer defaults on its obligations by failing to make the promised progress payments as and when they are due, the entity would have a right to all of the consideration promised in the contract if it completes the construction of the unit. The courts have previously upheld similar rights that entitle developers to require the customer to perform, subject to the entity meeting its obligations under the contract.

At contract inception, the entity applies paragraph 35(c) of IFRS 15 to determine whether its promise to construct and transfer the unit to the customer is a performance obligation satisfied over time. The entity determines that the asset (unit) created by the entity’s performance does not have an alternative use to the entity because the contract precludes the entity from transferring the specified unit to another customer. The entity does not consider the possibility of a contract termination in assessing whether the entity is able to direct the asset to another customer.

The entity also has a right to payment for performance completed to date in accordance with paragraphs 37 and B9–B13 of IFRS 15. This is because if the customer were to default on its obligations, the entity would have an enforceable right to all of the consideration promised under the contract if it continues to perform as promised.

Therefore, the terms of the contract and the practices in the legal jurisdiction indicate that there is a right to payment for performance completed to date. Consequently, the criteria in paragraph 35(c) of IFRS 15 are met and the entity has a performance obligation that it satisfies over time. To recognise revenue for that performance obligation satisfied over time, the entity measures its progress towards complete satisfaction of its performance obligation in accordance with paragraphs 39–45 and B14–B19 of IFRS 15.

In the construction of a multi-unit residential complex, the entity may have many contracts with individual customers for the construction of individual units within the complex. The entity would account for each contract separately. However, depending on the nature of the construction, the entity’s performance in undertaking the initial construction works (ie the foundation and the basic structure), as well as the construction of common areas, may need to be reflected when measuring its progress towards complete satisfaction of its performance obligations in each contract.
Extract from IFRS 15 (cont’d)

Case C—Entity has an enforceable right to payment for performance completed to date

The same facts as in Case B apply to Case C, except that in the event of a default by the customer, either the entity can require the customer to perform as required under the contract or the entity can cancel the contract in exchange for the asset under construction and an entitlement to a penalty of a proportion of the contract price.

Notwithstanding that the entity could cancel the contract (in which case the customer’s obligation to the entity would be limited to transferring control of the partially completed asset to the entity and paying the penalty prescribed), the entity has a right to payment for performance completed to date because the entity could also choose to enforce its rights to full payment under the contract. The fact that the entity may choose to cancel the contract in the event the customer defaults on its obligations would not affect that assessment (see paragraph B11 of IFRS 15), provided that the entity’s rights to require the customer to continue to perform as required under the contract (ie pay the promised consideration) are enforceable.

7.3 Repurchase agreements

Some agreements include repurchase provisions, either as part of a sales contract or as a separate contract that relates to the goods in the original agreement or similar goods. The standard clarifies the types of arrangements that qualify as repurchase agreements:

Extract from IFRS 15

B64. A repurchase agreement is a contract in which an entity sells an asset and also promises or has the option (either in the same contract or in another contract) to repurchase the asset. The repurchased asset may be the asset that was originally sold to the customer, an asset that is substantially the same as that asset, or another asset of which the asset that was originally sold is a component.

B65. Repurchase agreements generally come in three forms:

(a) an entity’s obligation to repurchase the asset (a forward);
(b) an entity’s right to repurchase the asset (a call option); and
(c) an entity’s obligation to repurchase the asset at the customer’s request (a put option).
7.3.1 Forward or call option held by the entity

When an entity has the unconditional obligation or right to repurchase an asset, the standard is clear that the customer has not obtained control of the asset. The standard provides the following application guidance:

**Extract from IFRS 15**

B66. If an entity has an obligation or a right to repurchase the asset (a forward or a call option), a customer does not obtain control of the asset because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though the customer may have physical possession of the asset. Consequently, the entity shall account for the contract as either of the following:

(a) a lease in accordance with IAS 17 Leases if the entity can or must repurchase the asset for an amount that is less than the original selling price of the asset; or

(b) a financing arrangement in accordance with paragraph B68 if the entity can or must repurchase the asset for an amount that is equal to or more than the original selling price of the asset.

The application guidance, in the extract above, requires that an entity account for a transaction including a forward or a call option based on the relationship between the repurchase price and the original selling price. The standard indicates that if the entity has the right or obligation to repurchase the asset at a price less than the original sales price (taking into consideration the effects of the time value of money), the entity would account for the transaction as a lease in accordance with IAS 17, unless the contract is part of a sale and leaseback transaction. If the entity has the right or obligation to repurchase the asset at a price equal to or greater than the original sales price (considering the effects of the time value of money), the entity would account for the contract as a financing arrangement. A similar assessment is required for put options (see Section 7.3.2 below).

If a transaction is considered a financing arrangement under the IFRS 15, the selling entity would continue to recognise the asset. In addition, it would record a financial liability for the consideration received from the customer. The difference between the consideration received from the customer and the consideration subsequently paid to the customer (upon repurchasing the asset) represents the interest and holding costs (as applicable) that are recognised over the term of the financing arrangement. If the option lapses unexercised, the entity derecognises the liability and recognises revenue at that time.

**What’s changing from current IFRS?**

Consistent with the current requirements in IFRS, the new standard requires an entity to consider a repurchase agreement together with the original sales agreement when they are linked in such a way that the substance of the arrangement cannot be understood without reference to the series of transactions as a whole.\(^{127}\) Therefore, for most entities, the requirement to consider the two transactions together would not change.

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\(^{127}\) IAS 18.13 and SIC-27
The requirement in the new standard to distinguish between repurchase agreements that are, in substance, leases or financing arrangements is broadly consistent with current IFRS. IAS 18 indicates that “the terms of the agreement need to be analysed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer”.\(^\text{128}\)

However, IAS 18 does not specify how to treat repurchase agreements that represent financing arrangements, except to state that such arrangements do not give rise to revenue. The requirements in IFRS 15 may, therefore, result in a significant change in practice for some entities.

**How we see it**

We believe the requirements for repurchase agreements could result in a significant change in practice for some entities given the limited guidance in current IFRS.

Entities may find the requirements challenging to apply in practice as the standard treats all forwards and call options the same way and does not consider the likelihood that they will be exercised.

The standard provides the following example of a call option:

**Extract from IFRS 15**

**Example 62 – Repurchase agreements (IFRS 15.IE315-IE318)**

An entity enters into a contract with a customer for the sale of a tangible asset on 1 January 20X7 for CU1 million.

**Case A—Call option: financing**

The contract includes a call option that gives the entity the right to repurchase the asset for CU1.1 million on or before 31 December 20X7.

Control of the asset does not transfer to the customer on 31 December 20X7 because the entity has a right to repurchase the asset and therefore the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Consequently, in accordance with paragraph B66(b) of IFRS 15, the entity accounts for the transaction as a financing arrangement, because the exercise price is more than the original selling price. In accordance with paragraph B68 of IFRS 15, the entity does not derecognise the asset and instead recognises the cash received as a financial liability. The entity also recognises interest expense for the difference between the exercise price (CU1.1 million) and the cash received (CU1 million), which increases the liability.

On 31 December 20X7, the option lapses unexercised; therefore, the entity derecognises the liability and recognises revenue of CU1.1 million.

**7.3.2 Written put option held by the customer**

IFRS 15 indicates that if the customer has the ability to require an entity to repurchase an asset (a put option) at a price lower than its original selling price, the entity considers, at contract inception, whether the customer has a significant economic incentive to exercise that right. That is, this determination influences whether the customer truly has control over the asset received.

\(^\text{128}\) IAS 18.IE5
The determination of whether an entity has a significant economic incentive to exercise its right will determine whether the arrangement is treated as a lease or a sale with the right of return (discussed in 5.2.2). An entity must consider all relevant facts and circumstances to determine whether a customer has a significant economic incentive to exercise its right, including the relationship of the repurchase price to the expected market value of the asset at the date of repurchase and the amount of time until the right expires. The standard notes that if the repurchase price is expected to significantly exceed the market value of the asset, the customer has a significant economic incentive to exercise the put option:

- If a customer has a significant economic incentive to exercise its right, the customer is expected to ultimately return the asset. The entity accounts for the agreement as a lease because the customer is effectively paying the entity for the right to use the asset for a period of time. However, one exception to this would be if the contract is part of a sale and leaseback, in which case the contract would be accounted for as a financing arrangement.

- If a customer does not have a significant economic incentive to exercise its right, the entity accounts for the agreement in a manner similar to a sale of a product with a right of return. The repurchase price of an asset that is equal to or greater than the original selling price, but less than or equal to the expected market value of the asset, must also be accounted for as a sale of a product with a right of return, if the customer does not have a significant economic incentive to exercise its right. See Section 5.2.2 for a discussion on sales with a right of return.

If the customer has the ability to require an entity to repurchase the asset at a price equal to, or more than, the original selling price and the repurchase price is more than the expected market value of the asset, the contract is in effect a financing. The standard provides the following application guidance in relation to the accounting treatment for a financing arrangement:

**Extract from IFRS 15**

B73. If the repurchase price of the asset is equal to or greater than the original selling price and is more than the expected market value of the asset, the contract is in effect a financing arrangement and, therefore, shall be accounted for as described in paragraph B68.

B74. If the repurchase price of the asset is equal to or greater than the original selling price and is less than or equal to the expected market value of the asset, and the customer does not have a significant economic incentive to exercise its right, then the entity shall account for the agreement as if it were the sale of a product with a right of return as described in paragraphs B20-B27.

**How we see it**

The new standard provides application guidance in respect of written put options where there is currently limited guidance under IFRS. However, the new standard does not provide any guidance on determining whether ‘a significant economic incentive’ exists and judgement may be required to make this determination.
The standard provides the following example of a put option:

**Extract from IFRS 15**

**Example 62 – Repurchase agreements (IFRS 15.IE315, IE319-IE321)**

An entity enters into a contract with a customer for the sale of a tangible asset on 1 January 20X7 for CU1 million.

**Case B–Put option: lease**

Instead of having a call option, the contract includes a put option that obliges the entity to repurchase the asset at the customer’s request for CU900,000 on or before 31 December 20X7. The market value is expected to be CU750,000 on 31 December 20X7.

At the inception of the contract, the entity assesses whether the customer has a significant economic incentive to exercise the put option, to determine the accounting for the transfer of the asset (see paragraphs B70–B76 of IFRS 15). The entity concludes that the customer has a significant economic incentive to exercise the put option because the repurchase price significantly exceeds the expected market value of the asset at the date of repurchase. The entity determines there are no other relevant factors to consider when assessing whether the customer has a significant economic incentive to exercise the put option. Consequently, the entity concludes that control of the asset does not transfer to the customer, because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

In accordance with paragraphs B70–B71 of IFRS 15, the entity accounts for the transaction as a lease in accordance with IAS 17 Leases.

**7.3.3 Sales with residual value guarantees**

An entity that sells equipment may use a sales incentive programme under which it guarantees that the customer will receive a minimum resale amount when it disposes of the equipment (i.e., a residual value guarantee). Judgement will be needed to determine the appropriate accounting treatment, which will depend on the specific facts and circumstances. In some cases, an entity may need to consider the requirements of other IFRSs to appropriately account for the residual value guarantee. In other situations, IFRS 15 may apply to the entire transaction.

The appropriate treatment of the entire transaction will depend on whether the repurchase agreements’ application guidance within IFRS 15 applies. For example, if the residual value guarantee is accomplished through a repurchase provision via a put option within the contract (e.g., the customer has the right to require the entity to repurchase equipment two years after the date of purchase at 85% of the original purchase price), the entity would have to use the application guidance in the standard to determine whether the existence of the put option precludes the customer from obtaining control of the acquired item. In such circumstances, the entity determines whether the customer has a significant economic incentive to exercise its put right. If the entity concludes that there is no significant economic incentive, the transaction would be accounted for as a sale in accordance with the standard. Alternatively, if the entity concludes there is a significant economic incentive for the customer to exercise its right, the transaction would be accounted for as a lease, as discussed in Section 7.3.2.
However, assume the transaction does not include a repurchase right, but instead, includes a residual value guarantee. If the entity guarantees it will compensate the customer (or ‘make whole’) on a qualifying future sale at less than 85% of the initial sale price, it does not appear that the application guidance on repurchase agreements in IFRS 15 would apply. That is, since the entity is not repurchasing the asset, that application guidance would not apply. Instead, an entity would need to assess whether the guarantee affects control of the asset transferring, which will depend on the promise to the customer. In some cases, it may not affect the transfer of control. The Basis for Conclusions to the standard notes that “when the entity guarantees that the customer will receive a minimum amount of sales proceeds, the customer is not constrained in its ability to direct the use of, and obtain substantially all of the benefits from, the asset.” However, while a residual value guarantee may not affect the transfer of control, an entity would need to consider whether it affects the transaction price (see Section 5 above). While the economics of a repurchase agreement and a residual value guarantee may be similar, the accounting could be quite different.

7.4 Bill-and-hold arrangements

In some sales transactions, the selling entity fulfils its obligations and bills the customer for the work performed, but does not ship the goods until a later date. These transactions, often called bill-and-hold transactions, are usually designed this way at the request of the purchaser for a number of reasons, including a lack of storage capacity or its inability to use the goods until a later date.

What’s changing from current IFRS?

The criteria for determining whether a bill-and-hold transaction qualifies for revenue recognition under the new standard are similar to current IFRS. We expect that most bill-and-hold transactions that qualify for revenue recognition under current IFRS will also qualify for revenue recognition under the new standard. However, consideration of a separate custodial performance obligation (as discussed in IFRS 15.B80) may be new to IFRS reporters, as this is not addressed in IAS 18.

The standard provides the following application guidance and an illustrative example with respect to these arrangements:

Extract from IFRS 15

B79. A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future. For example, a customer may request an entity to enter into such a contract because of the customer’s lack of available space for the product or because of delays in the customer’s production schedules.

129 IFRS 15.BC431
130 IAS 18.IE1
B80. An entity shall determine when it has satisfied its performance obligation to transfer a product by evaluating when a customer obtains control of that product (see paragraph 38). For some contracts, control is transferred either when the product is delivered to the customer’s site or when the product is shipped, depending on the terms of the contract (including delivery and shipping terms). However, for some contracts, a customer may obtain control of a product even though that product remains in an entity’s physical possession. In that case, the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the product even though it has decided not to exercise its right to take physical possession of that product. Consequently, the entity does not control the product. Instead, the entity provides custodial services to the customer over the customer’s asset.

B81. In addition to applying the requirements in paragraph 38, for a customer to have obtained control of a product in a bill-and-hold arrangement, all of the following criteria must be met:

(a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);
(b) the product must be identified separately as belonging to the customer;
(c) the product currently must be ready for physical transfer to the customer; and
(d) the entity cannot have the ability to use the product or to direct it to another customer.

B82. If an entity recognises revenue for the sale of a product on a bill-and-hold basis, the entity shall consider whether it has remaining performance obligations (for example, for custodial services) in accordance with paragraphs 22-30 to which the entity shall allocate a portion of the transaction price in accordance with paragraphs 73-86.
Extract from IFRS 15

Example 63 – Bill-and-hold arrangement (IFRS 15.IE323-IE327)

An entity enters into a contract with a customer on 1 January 20X8 for the sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is two years.

Upon completion of manufacturing, the entity demonstrates that the machine and spare parts meet the agreed-upon specifications in the contract. The promises to transfer the machine and spare parts are distinct and result in two performance obligations that each will be satisfied at a point in time. On 31 December 20X9, the customer pays for the machine and spare parts, but only takes physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at the entity’s warehouse because of its close proximity to the customer’s factory. The customer has legal title to the spare parts and the parts can be identified as belonging to the customer. Furthermore, the entity stores the spare parts in a separate section of its warehouse and the parts are ready for immediate shipment at the customer’s request. The entity expects to hold the spare parts for two to four years and the entity does not have the ability to use the spare parts or direct them to another customer.

The entity identifies the promise to provide custodial services as a performance obligation because it is a service provided to the customer and it is distinct from the machine and spare parts. Consequently, the entity accounts for three performance obligations in the contract (the promises to provide the machine, the spare parts and the custodial services). The transaction price is allocated to the three performance obligations and revenue is recognised when (or as) control transfers to the customer.

Control of the machine transfers to the customer on 31 December 20X9 when the customer takes physical possession. The entity assesses the indicators in paragraph 38 of IFRS 15 to determine the point in time at which control of the spare parts transfers to the customer, noting that the entity has received payment, the customer has legal title to the spare parts and the customer has inspected and accepted the spare parts. In addition, the entity concludes that all of the criteria in paragraph B81 of IFRS 15 are met, which is necessary for the entity to recognise revenue in a bill-and-hold arrangement. The entity recognises revenue for the spare parts on 31 December 20X9 when control transfers to the customer.

The performance obligation to provide custodial services is satisfied over time as the services are provided. The entity considers whether the payment terms include a significant financing component in accordance with paragraphs 60–65 of IFRS 15.

7.5 Customer acceptance

When determining whether the customer has obtained control of the goods or services, an entity must consider any customer acceptance clauses that require the customer to approve the goods or services before it is obligated to pay for them. These clauses may be straightforward, giving a customer the ability to accept or reject the goods or services based on objective criteria specified in the contract (e.g., the goods function at a specified speed), or they may be more subjective in nature. If a customer does not accept the goods or services, the seller may not be entitled to consideration and may be required to take remedial action or may be required to take back the delivered good.
The standard provides the following application guidance regarding how to evaluate customer acceptance provisions:

**Extract from IFRS 15**

B83. In accordance with paragraph 38(e), a customer’s acceptance of an asset may indicate that the customer has obtained control of the asset. Customer acceptance clauses allow a customer to cancel a contract or require an entity to take remedial action if a good or service does not meet agreed-upon specifications. An entity shall consider such clauses when evaluating when a customer obtains control of a good or service.

B84. If an entity can objectively determine that control of a good or service has been transferred to the customer in accordance with the agreed-upon specifications in the contract, then customer acceptance is a formality that would not affect the entity’s determination of when the customer has obtained control of the good or service. For example, if the customer acceptance clause is based on meeting specified size and weight characteristics, an entity would be able to determine whether those criteria have been met before receiving confirmation of the customer’s acceptance. The entity’s experience with contracts for similar goods or services may provide evidence that a good or service provided to the customer is in accordance with the agreed-upon specifications in the contract. If revenue is recognised before customer acceptance, the entity still must consider whether there are any remaining performance obligations (for example, installation of equipment) and evaluate whether to account for them separately.

B85. However, if an entity cannot objectively determine that the good or service provided to the customer is in accordance with the agreed-upon specifications in the contract, then the entity would not be able to conclude that the customer has obtained control until the entity receives the customer’s acceptance. That is because in that circumstance the entity cannot determine that the customer has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service.

B86. If an entity delivers products to a customer for trial or evaluation purposes and the customer is not committed to pay any consideration until the trial period lapses, control of the product is not transferred to the customer until either the customer accepts the product or the trial period lapses.

The determination of whether the acceptance criteria are subjective and whether they have been met may require professional judgement. However, this is generally consistent with current practice.

### 7.6 Licensing and rights to use

IFRS 15 provides a model for determining the timing of transfer of control for licences of intellectual property that is different from the general requirements, discussed in Section 7.1 above. Any licences of intellectual property that are determined to be distinct must apply this separate application guidance. We discuss licensing, rights to use and the satisfaction of those performance obligations in detail in Section 8.4.
Following issuance of their standards, both Boards decided to propose clarifications to the licences application guidance. While the IASB and FASB had jointly discussed how to clarify this application guidance, they did not agree on the nature and extent of all of the changes to propose (see Section 8.4.2 for further discussion). The IASB issued its exposure draft in July 2015.\footnote{Exposure draft ED/2015/6, Clarifications to IFRS 15 issued by the IASB in July 2015}

The FASB’s proposed changes were exposed for public comment in May 2015.\footnote{FASB Proposed ASU, Revenue from Contracts with Customers – Identifying Performance Obligations and Licensing, May 2015}

### 7.7 Recognising revenue when a right of return exists

As discussed in Section 4.7, a right of return does not represent a separate performance obligation. Instead, the existence of a right of return affects the transaction price and the entity must determine whether the customer will return the transferred product.

Under IFRS 15, an entity estimates the transaction price and recognises revenue based on the amounts to which the entity expects to be entitled through to the end of the return period (considering expected product returns). The entity recognises the amount of expected returns as a refund liability, representing its obligation to return the customer’s consideration. If the entity is unable to estimate returns, revenue would not be recognised until returns can be reasonably estimated, which may be at the end of the return period. An entity also would update its estimates at the end of each reporting period. See Section 5.2.2 for further discussion on this topic.

### 7.8 Breakage and prepayments for future goods or services

In certain industries, an entity will collect non-refundable payments from its customers for goods or services that the customer has a right to receive in the future. However, a customer may ultimately leave that right unexercised (often referred to as ‘breakage’). Retailers, for example, frequently sell gift cards that are not completely redeemed and airlines sometimes sell tickets to passengers who allow the tickets to expire unused. When an entity receives consideration that is attributable to a customer’s unexercised rights, the entity recognises a contract liability equal to the amount prepaid by the customer. Revenue would normally be recognised when the entity satisfies its performance obligation.

However, since entities will frequently not be required by customers to fully satisfy their performance obligations, the Boards concluded that when an entity expects to be entitled to a breakage amount, the expected breakage would be recognised as revenue in proportion to the pattern of rights exercised by the customer. Otherwise, breakage amounts would be recognised when the likelihood of the customer exercising its right becomes remote.

When estimating any breakage amount, an entity has to consider the constraint on variable consideration, as discussed in Section 5.1.3 above. That is, if it is highly probable that a significant revenue reversal would occur for any estimated breakage amounts, an entity would not recognise those amounts until the potential for reversal had passed.

As discussed above, the application guidance on breakage requires that an entity recognise a liability for the full amount of the prepayment. Then, it would recognise breakage on that liability proportionate to the revenue being recognised. This is clear in contracts with only a single element (e.g., a retailer sells a gift card to a customer).
However, if the prepayment element (e.g., the sale of a gift card, loyalty points) is part of a multiple-element arrangement, it is less clear how the application guidance on breakage is meant to interact with the requirements for determining the stand-alone selling price. In multiple-element arrangements, the entity must determine the stand-alone selling price of each performance obligation, including the prepaid element. If the stand-alone selling price for the prepaid element is not directly observable (e.g., the purchase of loyalty points), the standard requires an entity to estimate it. In making this estimate, it appears reasonable that an entity would take into consideration the likelihood that the customer ultimately will not request the services they have paid for in advance, or the potential breakage, as illustrated by Example 52 in IFRS 15, included in the extract below. However, considering the possibility that the item will not be redeemed as part of estimating the stand-alone sales price results in less revenue being allocated to the prepaid element. As a result, the deferred revenue associated with this element would be less than the contractual ‘prepayment’ amount.

**Extract from IFRS 15**

**Example 52 — Customer loyalty programme (IFRS 15.IE267-IE270)**

An entity has a customer loyalty programme that rewards a customer with one customer loyalty point for every CU10 of purchases. Each point is redeemable for a CU1 discount on any future purchases of the entity’s products. During a reporting period, customers purchase products for CU100,000 and earn 10,000 points that are redeemable for future purchases. The consideration is fixed and the stand-alone selling price of the purchased products is CU100,000. The entity expects 9,500 points to be redeemed. The entity estimates a stand-alone selling price of CU0.95 per point (totalling CU9,500) on the basis of the likelihood of redemption in accordance with paragraph B42 of IFRS 15.

The points provide a material right to customers that they would not receive without entering into a contract. Consequently, the entity concludes that the promise to provide points to the customer is a performance obligation. The entity allocates the transaction price (CU100,000) to the product and the points on a relative stand-alone selling price basis as follows:

<table>
<thead>
<tr>
<th>CU</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Product</td>
<td>91,324 [CU100,000 × (CU100,000 stand-alone selling price ÷ CU109,500)]</td>
</tr>
<tr>
<td>Points</td>
<td>8,676 [CU100,000 × (CU9,500 stand-alone selling price ÷ CU109,500)]</td>
</tr>
</tbody>
</table>

At the end of the first reporting period, 4,500 points have been redeemed and the entity continues to expect 9,500 points to be redeemed in total. The entity recognises revenue for the loyalty points of CU4,110 [(4,500 points ÷ 9,500 points) × CU8,676] and recognises a contract liability of CU4,566 (CU8,676 – CU4,110) for the unredeemed points at the end of the first reporting period.

At the end of the second reporting period, 8,500 points have been redeemed cumulatively. The entity updates its estimate of the points that will be redeemed and now expects that 9,700 points will be redeemed. The entity recognises revenue for the loyalty points of CU3,493 ((8,500 total points redeemed ÷ 9,700 total points expected to be redeemed) × CU8,676 initial allocation) - CU4,110 recognised in the first reporting period) for the unredeemed points at the end of the first reporting period. The contract liability balance is CU1,073 (CU8,676 initial allocation – CU7,603 of cumulative revenue recognised).
7.9 Onerous contracts

Under current IFRS, some entities are required to recognise an onerous contract provision for certain contracts. IFRS 15 indicates that entities will continue to be required to accrue expected losses on contracts under IAS 37. Onerous contracts are discussed in detail in Section 8.2.
8 Other measurement and recognition topics

8.1 Warranties

Warranties are commonly included in arrangements to sell goods or services, whether explicitly stated or implied based on the entity’s customary business practices. The price may be included in the overall purchase price of such warranties or listed separately as an optional product. The standard identifies two types of warranties:

- Warranties that provide a service to the customer in addition to assurance that the delivered product is as specified in the contract (called ‘service-type warranties’)
- Warranties that promise the customer that the delivered product is as specified in the contract (called ‘assurance-type warranties’)

8.1.1 Service-type warranties

If the customer has the option to purchase the warranty separately or if the warranty provides a service to the customer beyond fixing defects that existed at the time of sale, the entity is providing a service-type warranty. The Boards determined that this type of warranty represents a distinct service and is a separate performance obligation. Therefore, using the estimated stand-alone selling price of the warranty, the entity allocates a portion of the transaction price to the warranty (see Section 6). The entity then recognises the allocated revenue over the period the warranty service is provided.

Judgement may be required to determine the appropriate pattern of revenue recognition associated with service-type warranties. For example, an entity may determine that it provides the warranty service continuously over the warranty period (i.e., the performance obligation is an obligation to ‘stand ready to perform’ during the stated warranty period). An entity that makes this determination will likely recognise revenue rateably over the warranty period. An entity also may conclude that a different pattern of recognition is appropriate based on sufficient data about when it provides such services. For example, an entity might recognise little or no revenue in the first year of a three-year service-type warranty if historical data indicates that warranty services are typically provided in the second and third year of the warranty period only.

Changes in the estimate of the costs to satisfy service-type warranty performance obligations do not result in a revision to the original relative stand-alone selling price allocation. For example, an entity may discover two months after a product is shipped that the cost of a part acquired from a third-party manufacturer has tripled and that it will cost the entity significantly more to replace that part if a warranty claim is made. This change will not affect the amount of transaction price that the entity allocates to the service-type warranty because the service-type warranty cost recognition does not affect the revenue recognition.

8.1.2 Assurance-type warranties

The Boards concluded that assurance-type warranties do not provide an additional good or service to the customer (i.e., they are not separate performance obligations). By providing this type of warranty, the selling entity has effectively provided a guarantee of quality. Under the standard, these types of warranties are accounted for as warranty obligations and the estimated cost of satisfying them is accrued in accordance with the requirements in IAS 37. Once recorded, the warranty liability is assessed on an ongoing basis in accordance with IAS 37.
8.1.3 Determining whether a warranty is an assurance-type or service-type warranty

In some circumstances, it may be difficult to determine whether a warranty provides a customer with a service in addition to the assurance that the delivered product is as specified in the contract. To help entities make that assessment, the standard provides the following application guidance:

**Extract from IFRS 15**

B31. In assessing whether a warranty provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, an entity shall consider factors such as:

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

(b) The length of the warranty coverage period—the longer the coverage period, the more likely it is that the promised warranty is a performance obligation because it is more likely to provide a service in addition to the assurance that the product complies with agreed-upon specifications.

(c) The nature of the tasks that the entity promises to perform—if it is necessary for an entity to perform specified tasks to provide the assurance that a product complies with agreed-upon specifications (for example, a return shipping service for a defective product), then those tasks likely do not give rise to a performance obligation.

**How we see it**

Entities may need to exercise significant judgement when determining whether a warranty is an assurance-type or service-type warranty. An entity’s evaluation may be affected by several factors including common warranty practices within its industry and the entity’s business practices related to warranties. For example, consider an automotive manufacturer that provides a five-year warranty on a luxury vehicle and a three-year warranty on a standard vehicle. The manufacturer may conclude that the longer warranty period is not an additional service because it believes the materials used to construct the luxury vehicle are of a higher quality and that latent defects would take longer to appear. In contrast, the manufacturer may also compare the warranty with those offered by its competitors and conclude that the five-year warranty period, or some portion of it, is an additional service that needs to be accounted for as a service-type warranty. The standard excludes product liabilities, which are accounted for in accordance with IAS 37.
### Summary of recent TRG discussions

**Evaluating whether a product warranty is a service-type warranty (i.e., a performance obligation) when it is not separately priced**

As discussed above, determining whether a warranty is a service-type warranty (i.e., a performance obligation) may require judgement. At the March 2015 TRG meeting, members of the TRG were asked to consider how an entity would evaluate whether a product warranty is a service-type warranty (i.e., a performance obligation) when it is not separately priced.

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; 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.

### 8.1.4 Contracts that contain both assurance and service-type warranties

Some contracts may include both an assurance-type warranty and a service-type warranty, as illustrated below. However, if an entity provides both an assurance-type and service-type warranty within a contract and the entity cannot reasonably account for them separately, the warranties are accounted for as a single performance obligation (i.e., revenue would be allocated to the combined warranty and recognised over the period the warranty services are provided).

When an assurance-type warranty and a service-type warranty can be accounted for separately, an entity is required to accrue for the expected costs associated with the assurance-type warranty and defer the revenue for the service-type warranty. The following illustration highlights this point:

#### Illustration 8-1 – Service-type and assurance-type warranties

An entity manufactures and sells computers that include an assurance-type warranty for the first 90 days. The entity offers an optional ‘extended coverage’ plan under which it will repair or replace any defective part for three years from the expiration of the assurance-type warranty. Since the optional ‘extended coverage’ plan is sold separately, the entity determines that the three years of extended coverage represent a separate performance obligation (i.e., a service-type warranty).

The total transaction price for the sale of a computer and the extended warranty is CU3,600. The entity determines the stand-alone selling price of each is CU3,200 and CU400, respectively. The inventory value of the computer is CU1,440. Furthermore, the entity estimates that, based on its experience, it will incur CU200 in costs to repair defects that arise within the 90-day coverage period for the assurance-type warranty. As a result, the entity will record the following entries:

<table>
<thead>
<tr>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash/Trade receivables</td>
<td>Warranty expense</td>
</tr>
<tr>
<td>CU3,600</td>
<td>CU200</td>
</tr>
<tr>
<td>Dr. Warranty expense</td>
<td>Cr. Accrued warranty costs (assurance-type warranty)</td>
</tr>
<tr>
<td></td>
<td>CU200</td>
</tr>
<tr>
<td>Cr. Contract liability (service-type warranty)</td>
<td>CU400</td>
</tr>
<tr>
<td>Cr. Revenue</td>
<td>CU3,200</td>
</tr>
</tbody>
</table>

To record revenue and contract liabilities related to warranties.
Illustration 8-1 — Service-type and assurance-type warranties

<table>
<thead>
<tr>
<th>Dr. Cost of goods sold</th>
<th>CU1,440</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cr. Inventory</td>
<td>CU1,440</td>
</tr>
</tbody>
</table>

To relieve inventory and recognise cost of goods sold.

The entity derecognises the accrued warranty liability associated with the assurance-type warranty as actual warranty costs are incurred during the first 90 days after the customer receives the computer. The entity recognises the contract liability associated with the service-type warranty as revenue during the contract warranty period and recognises the costs associated with providing the service-type warranty as they are incurred. That is, the entity would need to be able to determine whether the repair costs incurred are applied against the warranty reserve already established or recognised as an expense as incurred.

Accounting for assurance-type warranties and service-type warranties simultaneously may be complex. Entities may need to develop processes to match individual warranty claims with the specific warranty plans so claims can be analysed for appropriate accounting treatment. This individual assessment of warranty claims is necessary because the assurance-type warranty costs will have been accrued previously, while the service-type warranty costs are an expense recognised as incurred. See Illustration 8-2 below for an example of this point.

Illustration 8-2 — Service-type and assurance-type warranty costs

Assume the same facts as in Illustration 8-1, but assume the entity sold 500 computers during the year. In January of the following year, CU10,000 of warranty claims are submitted by customers. The entity analyses each claim and identifies the specific computer sale to which the claims relate, which it needs to do in order to determine eligibility under the warranty plans and the appropriate accounting treatment.

The entity determines that a portion of the claims, costing CU2,500 for repair and replacement parts, are covered by the assurance-type warranty plan. As shown above in Illustration 8-1, the expected cost of each assurance-type warranty was accrued at the time of the sale. The entity records the following entry to derecognise a portion of the warranty liability:

Dr. Accrued warranty costs (assurance-type warranty) CU2,500
Cr. Cash CU2,500

To derecognise the assurance-type warranty liability as the costs are incurred.

The entity also determines that a portion of the claims, costing CU7,000 for repair and replacement parts, are eligible under the ‘extended coverage’ plan (i.e., the service-type warranty). The entity records the following entry to recognise the costs associated with the service-type warranty:

Dr. Warranty expense CU7,000
Cr. Cash CU7,000

To record the costs of the service-type warranty as the costs are incurred.

The entity also determines that CU500 of the claims are not eligible under either warranty plan because the claims relate to incidents that occurred after the 90-day coverage period for the assurance-type warranty and to sales for which the customer did not purchase the extended warranty coverage. The entity rejects these customer claims.
What’s changing from current IFRS?

The requirements for assurance-type warranties, as discussed in Section 8.1.2, are essentially the same as current practice under IFRS. The requirements for service-type warranties may differ from current practice, particularly in relation to the amount of transaction price that is allocated to the warranty performance obligation, as is discussed in Section 8.1.1. Currently, entities that provide separate extended warranties often defer an amount equal to the stated price of the warranty and record that amount as revenue evenly over the warranty period. IFRS 15 requires an entity to defer an allocated amount, based on a relative stand-alone selling price allocation, which, in most cases, will increase judgement and complexity.

8.2 Onerous contracts

During development of the standard, the Boards had proposed requiring entities to accrue for situations in which they expected to incur a loss, either on a single performance obligation (called an onerous performance obligation) or on an entire contract (called an onerous contract). In response to negative feedback received on the November 2011 exposure draft, the Boards decided not to include these requirements in the final standard. Instead, the Boards decided to retain their respective existing requirements for these situations. As a result, the accounting treatment in this area is not converged; that is, the current requirements for onerous contracts are not consistent between IFRS and US GAAP.

Under current US GAAP, while requirements exist for some industries or for certain types of transactions, there is no general authoritative standard for when to recognise losses on onerous contracts and, if a loss is to be recognised, how to measure the loss. Accordingly, there is diversity in practice when such contracts are not within the scope of specific authoritative literature. Since the FASB retained existing US GAAP requirements for onerous contracts, this diversity in practice will likely continue.

Under IFRS, the requirements in IAS 37 for onerous contracts apply to all contracts in the scope of IFRS 15. The new standard states that entities that are required to recognise a liability for expected losses on contracts under IAS 37 will continue to be required to do so. IAS 37 requires the following in respect of onerous contracts:

**Extract from IAS 37**

66. If an entity has a contract that is onerous, the present obligation under the contract shall be recognised and measured as a provision.

67. Many contracts (for example, some routine purchase orders) can be cancelled without paying compensation to the other party, and therefore there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties. Where events make such a contract onerous, the contract falls within the scope of this Standard and a liability exists which is recognised. Executory contracts that are not onerous fall outside the scope of this Standard.

68. This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

69. Before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets dedicated to that contract (see IAS 36).
8.3 Contract costs

IFRS 15 specifies the accounting treatment for costs an entity incurs in obtaining and fulfilling a contract to provide goods and services to customers for both contracts obtained and contracts under negotiation.

In July 2015, members of the TRG discussed how an entity would account for restocking fees and related costs for goods that are expected to be returned. See a summary of the recent TRG’s discussions in Section 5.2.2 above.

8.3.1 Costs to obtain a contract

Under IFRS 15, the incremental costs of obtaining a contract (i.e., costs that would not have been incurred if the contract had not been obtained) are recognised as an asset if the entity expects to recover them. This may mean direct recovery (i.e., through reimbursement under the contract) or indirect recovery (i.e., through the margin inherent in the contract). As a practical expedient, the standard permits an entity to immediately expense contract acquisition costs when the asset that would have resulted from capitalising such costs would have been amortised in one year or less. While not explicitly stated, we believe entities are permitted to choose this approach as an accounting policy election and, if they do, must apply it consistently to all short-term contract acquisition costs.

The standard cites sales commissions as an example of an incremental cost that may require capitalisation under the standard. For example, sales commissions that are directly related to sales achieved during a time period would likely represent incremental costs that would require capitalisation. In contrast, some bonuses and other compensation that are based on other quantitative or qualitative metrics (e.g., profitability, earnings per share (EPS), performance evaluations) likely do not meet the criteria for capitalisation because they are not directly related to obtaining a contract. Another example of an incremental cost may be a legal contingency cost when a lawyer agrees to receive payment only upon the successful completion of a negotiation. Determining which costs must be capitalised under the standard may require judgement.

The standard provides the following example regarding incremental costs of obtaining a contract:

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**Extract from IFRS 15**

**Example 36 — Incremental costs of obtaining a contract (IFRS 15.IE189-IE191)**

An entity, a provider of consulting services, wins a competitive bid to provide consulting services to a new customer. The entity incurred the following costs to obtain the contract:

<table>
<thead>
<tr>
<th>CU</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>External legal fees for due diligence</td>
<td>15,000</td>
</tr>
<tr>
<td>Travel costs to deliver proposal</td>
<td>25,000</td>
</tr>
<tr>
<td>Commissions to sales employees</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Total costs incurred</strong></td>
<td><strong>50,000</strong></td>
</tr>
</tbody>
</table>

In accordance with paragraph 91 of IFRS 15, the entity recognises an asset for the CU10,000 incremental costs of obtaining the contract arising from the commissions to sales employees because the entity expects to recover those costs through future fees for the consulting services. The entity also pays discretionary annual bonuses to sales supervisors based on annual sales targets, overall profitability of the entity and individual performance
Extract from IFRS 15 (cont’d)

evaluations. In accordance with paragraph 91 of IFRS 15, the entity does not recognise an asset for the bonuses paid to sales supervisors because the bonuses are not incremental to obtaining a contract. The amounts are discretionary and are based on other factors, including the profitability of the entity and the individuals' performance. The bonuses are not directly attributable to identifiable contracts.

The entity observes that the external legal fees and travel costs would have been incurred regardless of whether the contract was obtained. Therefore, in accordance with paragraph 93 of IFRS 15, those costs are recognised as expenses when incurred, unless they are within the scope of another Standard, in which case, the relevant provisions of that Standard apply.

How we see it

IFRS 15 represents a significant change for entities that currently expense the costs of obtaining a contract and will be required to capitalise them under the new standard. In addition, this may be a change for entities that currently capitalise costs to obtain a contract, particularly if the amounts currently capitalised are not incremental and, therefore, would not be eligible for capitalisation under IFRS 15.

Summary of recent TRG discussions

Interaction between IFRS 15 requirements for costs to obtain a contract and liabilities requirements in other standards

At the January 2015 TRG meeting, members of the TRG were asked to consider a number of questions related to capitalising costs to obtain a contract. For example, when, and for how much, an entity would capitalise in relation to commissions that are paid on renewal contracts. Also, how an entity would determine 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 agenda paper, TRG members discussed the underlying principle for capitalising costs under the standards. TRG members generally agreed that IFRS 15 did not amend the current liabilities standards (e.g., IAS 37). 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 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.

8.3.2 Costs to fulfil a contract

The standard divides contract fulfilment costs into two categories: (1) costs that give rise to an asset; and (2) costs that are expensed as incurred. When determining the appropriate accounting treatment for such costs, IFRS 15 makes it clear that any other applicable standards are considered first. If those other standards preclude capitalisation of a particular cost, then an asset cannot be recognised under IFRS 15.

Extract from IFRS 15

95. If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, IAS 2 Inventories, IAS 16 Property, Plant and Equipment or IAS 38 Intangible Assets), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

(a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);

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

(c) the costs are expected to be recovered.

96. For costs incurred in fulfilling a contract with a customer that are within the scope of another Standard, an entity shall account for those costs in accordance with those other Standards.

IFRS 15 states that costs can be capitalised even if the related revenue contract with the customer is not finalised. However, rather than allowing costs to be related to any potential future contract, the standard requires that the costs be associated with a specifically identifiable anticipated contract.

The standard discusses and provides examples of costs that may meet the first criterion for capitalisation (i.e., costs that relate directly to the contract) as follows:

Extract from IFRS 15

97. Costs that relate directly to a contract (or a specific anticipated contract) include any of the following:

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

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

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

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

(e) other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors).
When determining whether costs meet the criteria for capitalisation, an entity must consider its specific facts and circumstances. An example of costs incurred that generate or enhance resources of the entity that will be used in satisfying performance obligations in the future may be the intangible design and engineering costs related to future performance that provide (or continue to provide) benefit over the term of the contract.

For costs to meet the ‘expected to be recovered’ criterion, they need to be either explicitly reimbursable under the contract, or reflected through the pricing on the contract and recoverable through margin.

**Extract from IFRS 15**

**Example 37 – Costs that give rise to an asset (IFRS 15.IE192-IE196)**

An entity enters into a service contract to manage a customer’s information technology data centre for five years. The contract is renewable for subsequent one-year periods. The average customer term is seven years. The entity pays an employee a CU10,000 sales commission upon the customer signing the contract. Before providing the services, the entity designs and builds a technology platform for the entity’s internal use that interfaces with the customer’s systems. That platform is not transferred to the customer, but will be used to deliver services to the customer.

**Incremental costs of obtaining a contract**

In accordance with paragraph 91 of IFRS 15, the entity recognises an asset for the CU10,000 incremental costs of obtaining the contract for the sales commission because the entity expects to recover those costs through future fees for the services to be provided. The entity amortises the asset over seven years in accordance with paragraph 99 of IFRS 15, because the asset relates to the services transferred to the customer during the contract term of five years and the entity anticipates that the contract will be renewed for two subsequent one-year periods.

**Costs to fulfil a contract**

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

<table>
<thead>
<tr>
<th></th>
<th>CU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Design services</td>
<td>40,000</td>
</tr>
<tr>
<td>Hardware</td>
<td>120,000</td>
</tr>
<tr>
<td>Software</td>
<td>90,000</td>
</tr>
<tr>
<td>Migration and testing of data centre</td>
<td>100,000</td>
</tr>
<tr>
<td><strong>Total costs</strong></td>
<td><strong>350,000</strong></td>
</tr>
</tbody>
</table>

The initial setup costs relate primarily to activities to fulfil the contract but do not transfer goods or services to the customer. The entity accounts for the initial setup costs as follows:

(a) hardware costs—accounted for in accordance with IAS 16 *Property, Plant and Equipment*.

(b) software costs—accounted for in accordance with IAS 38 *Intangible Assets*.

(c) costs of the design, migration and testing of the data centre—assessed in accordance with paragraph 95 of IFRS 15 to determine whether an asset can be recognised for the costs to fulfil the contract. Any resulting asset would be amortised on a systematic basis over the seven-year period (ie the five-year contract term and two anticipated one-year renewal periods) that the entity expects to provide services related to the data centre.
In addition to the initial costs to set up the technology platform, the entity also assigns two employees who are primarily responsible for providing the service to the customer. Although the costs for these two employees are incurred as part of providing the service to the customer, the entity concludes that the costs do not generate or enhance resources of the entity (see paragraph 95(b) of IFRS 15). Therefore, the costs do not meet the criteria in paragraph 95 of IFRS 15 and cannot be recognised as an asset using IFRS 15. In accordance with paragraph 98, the entity recognises the payroll expense for these two employees when incurred.

IFRS 15 requires that if the costs incurred in fulfilling a contract do not give rise to an asset based on the criteria, specified above, they must be expensed as incurred. The standard provides some common examples of costs that must be expensed as incurred, as follows:

**Extract from IFRS 15**

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

(a) general and administrative costs (unless those costs are explicitly chargeable to the customer under the contract, in which case an entity shall evaluate those costs in accordance with paragraph 97);

(b) costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the price of the contract;

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

(d) costs for which an entity cannot distinguish whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations (or partially satisfied performance obligations).

If an entity is unable to determine whether certain costs relate to past or future performance and the costs are not eligible for capitalisation under other IFRSs, the costs are expensed as incurred.

**Summary of recent TRG discussions**

**Accounting for fulfilment costs incurred prior to the contract establishment date that are outside the scope of another standard**

As discussed above, an entity can capitalise certain fulfilment costs on specifically identified anticipated contracts, if specified criteria are met. Entities sometimes will begin activities on a specifically anticipated contract either:

- Before agreeing to the contract with the customer
  - Or
- Before the contract satisfies the criteria to be accounted for under IFRS 15 (contract establishment date)

At the March 2015 TRG meeting, members of the TRG discussed how an entity would account for fulfilment costs incurred prior to the contract establishment date that are outside the scope of another standard (e.g., IAS 2 Inventories). See a summary of the recent TRG's discussions in Section 7.1.4 above on measuring progress for performance obligations that are partially complete at the contract establishment date.
Summary of recent TRG discussions (cont’d)

TRG members generally agreed that costs in respect of pre-contract establishment date activities that relate to a good or service that will transfer to the customer at or after the contract establishment date may be capitalised as costs to fulfil a specifically anticipated contract. However, TRG members noted that such costs would still need to meet the 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 contract establishment date 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.

8.3.3 Amortisation and impairment of capitalised costs

Any capitalised contract costs are ultimately amortised, with the expense recognised as the entity transfers the goods or services to the customer. It is important to note that certain capitalised costs will relate to multiple goods and services (e.g., design costs). For these costs, the amortisation period could extend beyond a single contract if the capitalised costs relate to goods or services being transferred under multiple contracts, or to a specific anticipated contract, such as when the customer is expected to renew its current services contract for another term.

Illustration 8-3 – Amortisation period

Entity A enters into a three-year contract with a customer for transaction processing services. To fulfil the contract, Entity A incurred set-up costs of CU60,000, which it capitalised and will amortise over the term of the contract.

At the beginning of the third year, the customer renews the contract for an additional two years. Entity A will benefit from the set-up costs during the additional two-year period. Therefore, it changes the remaining amortisation period from one to three years and adjusts the amortisation expense recognised in accordance with the requirements in IAS 8 for changes in accounting estimates.

However, under IFRS 15, if Entity A had been in the position to anticipate the contract renewal at contract inception, Entity A would have amortised the set-up costs over the anticipated term of the contract including the expected renewal (i.e., five years).

Any asset recorded by the entity is subject to an assessment of impairment at the end of each reporting period. This is because costs that give rise to an asset must continue to be recoverable throughout the contract, in order to meet the criteria for capitalisation.

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 associated goods and services, less the remaining costs that relate directly to providing those good and services.

When an entity determines the amount it expects to receive (see Section 5), the requirements for constraining estimates of variable consideration are not considered. That is, if an entity were required to reduce the estimated transaction price because of the required constraint on variable consideration, it would use the unconstrained transaction price for the impairment test. While unconstrained, this amount must be reduced to reflect the customer’s credit risk before it is used in the impairment test.
However, before recognising an impairment loss on capitalised costs incurred to obtain or fulfil a contract, the entity will need to consider impairment losses recognised in accordance with another standard (e.g., IAS 36 *Impairment of Assets*). After applying the impairment test to the capitalised costs, an entity includes the resulting carrying amount in the carrying amount of a cash-generating unit for purposes of applying the requirements in IAS 36.

The Boards diverged on the reversal of impairment losses in subsequent periods. Under US GAAP, the reversal of previous impairment losses is prohibited. In contrast, under IFRS, IAS 36 permits the reversal of some or all of previous impairment losses on assets (other than goodwill) or cash-generating units if the estimates used to determine the assets’ recoverable amount have changed. Consistent with IAS 36, IFRS 15 permits reversal of impairment losses.

### Summary of recent TRG discussions

**Testing capitalised contract costs for impairment: Determining whether to include contract renewals or extensions in the remaining amount of consideration the entity expects to receive**

At the July 2014 TRG meeting, members of the TRG were asked to consider whether an entity should consider contract renewals or extensions (and, thereby, include the related future cash flows it expects to receive) when it tests a capitalised contract cost asset for impairment. 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.

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. IFRS 15 indicates that costs capitalised under the standard could relate to goods or services to be transferred under ‘a specific anticipated contract’ (e.g., goods or services to be provided under contract renewals and/or extensions). The standard also indicates that an impairment loss would be recognised when the carrying amount of the asset exceeds the remaining amount of consideration expected to be received (determined by using principles in IFRS 15 for determining the transaction price, see Section 5 above). However, the requirements for measuring the transaction price in IFRS 15 indicate that an entity should not anticipate that the contract will be “cancelled, renewed or modified” when determining the transaction price.

### 8.4 Licences of intellectual property

IFRS 15 provides application guidance specific to the recognition of revenue for licences of intellectual property, which differs slightly from the requirements applied to all other promised goods and services. Licences of intellectual property may include licences for any of the following: software and technology, media and entertainment (e.g., motion pictures and music), franchises, patents, trademarks and copyrights.

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134 IAS 36.109-125
135 IFRS 15.104
136 IFRS 15.99
137 IFRS 15.101(a), 102
138 IFRS 15.49
The Boards concluded that specific criteria were necessary to determine the underlying nature of the entity's promise in granting the licence (i.e., whether it is transferred to the customer at a point in a time or over time). The Boards concluded that these additional requirements were necessary because they believed it was difficult to determine when a customer obtains control of assets in a licence without first identifying the nature of the licence and the entity's related performance obligations. These concepts are discussed further below.

Following issuance of their standards, both Boards decided to propose clarifications to the licences application guidance. While the IASB and FASB had jointly discussed how to clarify this application guidance, they did not agree on the nature and extent of all of the changes to propose (see Sections 8.4.2 and 8.4.4 for further discussion). The IASB issued its exposure draft in July 2015. The FASB's proposed changes were exposed for public comment in May 2015.

8.4.1 Determining whether a licence is distinct

The application guidance provided on licences of intellectual property is only applicable to licences that are distinct. When the licence is the only promised item (either explicitly or implicitly) in the contract, the application guidance is clearly applicable to that licence.

However, licences of intellectual property are frequently included in multiple-element arrangements with promises for additional goods and services that may be explicit or implicit. In these situations, an entity first determines whether the licence of intellectual property is distinct, as discussed in Sections 4.1 and 4.2. This includes assessing whether the customer can benefit from the licence on its own or together with readily available resources. While licences of intellectual property are frequently capable of being distinct, in many cases, the customer can only benefit from the licence when it is combined with another good or service. For example, a software licence may be part of a software-enabled tangible good in which the software significantly influences the features and functionality of the tangible good. In addition, an entity may provide a customer with the licence for software, but only in conjunction with a hosting service (and the customer cannot use the software without the hosting). In both examples, the customer cannot benefit from the licence on its own and, therefore, the licence is not distinct. As such, it would be combined with the other promised goods or services.

For most licences that are not distinct, an entity would follow the requirements for other goods and services to account for the combined performance obligation (i.e., the requirements in IFRS 15.31-36 to determine whether the combined performance obligation transfers over time or at a point in time, as discussed in Sections 7.1 and 7.2).

In the Basis for Conclusions, the Boards noted that there may be some situations in which, even though the licence is not distinct from the good or service transferred with the licence, the licence is the primary or dominant component of the combined item. In such situations, the Boards concluded that the incremental application guidance for licences would still be applied. However, the Boards provided no application guidance or examples for determining when a licence is the primary or dominant component.

139 Exposure draft ED/2015/6, Clarifications to IFRS 15 issued by the IASB in July 2015
140 FASB Proposed ASU, Revenue from Contracts with Customers – Identifying Performance Obligations and Licensing, May 2015
141 IFRS 15.BC407
As discussed in Section 8.4.2, in May 2015, the FASB proposed an amendment to ASC 606 to clarify that an entity would apply the licences application guidance for a bundled performance obligation comprising a licence of intellectual property and other goods or services to help determine the nature of the promise in granting the licence and, therefore, the pattern of revenue recognition for the overall performance obligation.

The standard includes the following example to illustrate the determination of whether a licence is distinct. In July 2015, the IASB proposed clarifications to this example, but these have not been reflected in the text below.

**Extract from IFRS 15**

**Example 56 – Identifying a distinct licence (IFRS 15.IE281-IE288)**

An entity, a pharmaceutical company, licenses to a customer its patent rights to an approved drug compound for 10 years and also promises to manufacture the drug for the customer. The drug is a mature product; therefore the entity will not undertake any activities to support the drug, which is consistent with its customary business practices.

**Case A—Licence is not distinct**

In this case, no other entity can manufacture this drug because of the highly specialised nature of the manufacturing process. As a result, the licence cannot be purchased separately from the manufacturing services.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of IFRS 15. The entity determines that the customer cannot benefit from the licence without the manufacturing service; therefore, the criterion in paragraph 27(a) of IFRS 15 is not met. Consequently, the licence and the manufacturing service are not distinct and the entity accounts for the licence and the manufacturing service as a single performance obligation.

The entity applies paragraphs 31–38 of IFRS 15 to determine whether the performance obligation (ie the bundle of the licence and the manufacturing services) is a performance obligation satisfied at a point in time or over time.

**Case B—Licence is distinct**

In this case, the manufacturing process used to produce the drug is not unique or specialised and several other entities can also manufacture the drug for the customer.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of IFRS 15. Because the manufacturing process can be provided by other entities, the entity concludes that the customer can benefit from the licence on its own (ie without the manufacturing service) and that the licence is separately identifiable from the manufacturing process (ie the criteria in paragraph 27 of IFRS 15 are met). Consequently, the entity concludes that the licence and the manufacturing service are distinct and the entity has two performance obligations:

(a) licence of patent rights; and

(b) manufacturing service.
The entity assesses, in accordance with paragraph B58 of IFRS 15, the nature of the entity’s promise to grant the licence. The drug is a mature product (i.e., it has been approved, is currently being manufactured and has been sold commercially for the last several years). For these types of mature products, the entity’s customary business practices are not to undertake any activities to support the drug. Consequently, the entity concludes that the criteria in paragraph B58 of IFRS 15 are not met because the contract does not require, and the customer does not reasonably expect, the entity to undertake activities that significantly affect the intellectual property to which the customer has rights. In its assessment of the criteria in paragraph B58 of IFRS 15, the entity does not take into consideration the separate performance obligation of promising to provide a manufacturing service. Consequently, the nature of the entity’s promise in transferring the licence is to provide a right to use the entity’s intellectual property in the form and the functionality with which it exists at the point in time that it is granted to the customer. Consequently, the entity accounts for the licence as a performance obligation satisfied at a point in time.

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

8.4.2 Determining the nature of the entity’s promise

For all licences of intellectual property that are determined to be distinct, an entity must determine the nature of the promise to the customer. The standard states that entities provide their customers with either:

- A right to access the entity’s intellectual property as it exists throughout the licence period, including any changes to that intellectual property (‘a right to access’)

  Or

- A right to use the entity’s intellectual property as it exists at the point in time in which the licence is granted (‘a right to use’)

To determine whether a licence is a right to access or a right to use the intellectual property (which is important when determining the period of performance and, therefore, the timing of revenue recognition), the Boards provided the following application guidance:

B57. To determine whether an entity’s promise to grant a licence provides a customer with either a right to access an entity’s intellectual property or a right to use an entity’s intellectual property, an entity shall consider whether a customer can direct the use of, and obtain substantially all of the remaining benefits from, a licence at the point in time at which the licence is granted. A customer cannot direct the use of, and obtain substantially all of the remaining benefits from, a licence at the point in time at which the licence is granted if the intellectual property to which the customer has rights changes throughout the licence period. The intellectual property will change (and thus affect the entity’s assessment of when the customer controls the licence) when the entity continues to be involved with its intellectual property and the entity undertakes activities that significantly affect the intellectual property to which the customer has rights. In these cases, the licence provides the customer with...
Extract from IFRS 15 (cont’d)

a right to access the entity’s intellectual property (see paragraph B58). In contrast, a customer can direct the use of, and obtain substantially all of the remaining benefits from, the licence at the point in time at which the licence is granted if the intellectual property to which the customer has rights will not change (see paragraph B61). In those cases, any activities undertaken by the entity merely change its own asset (ie the underlying intellectual property), which may affect the entity’s ability to provide future licences; however, those activities would not affect the determination of what the licence provides or what the customer controls.

B58. The nature of an entity’s promise in granting a licence is a promise to provide a right to access the entity’s intellectual property if all of the following criteria are met:

(a) the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the intellectual property to which the customer has rights (see paragraph B59);
(b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity’s activities identified in paragraph B58(a); and
(c) those activities do not result in the transfer of a good or a service to the customer as those activities occur (see paragraph 25).

B59. Factors that may indicate that a customer could reasonably expect that an entity will undertake activities that significantly affect the intellectual property include the entity’s customary business practices, published policies or specific statements. Although not determinative, the existence of a shared economic interest (for example, a sales-based royalty) between the entity and the customer related to the intellectual property to which the customer has rights may also indicate that the customer could reasonably expect that the entity will undertake such activities.

In providing this application guidance, the Boards decided to focus on the characteristics of a licence that is a right to provide access. If the licensed intellectual property does not have those characteristics, it is a right to use a licence, by default. This analysis is focused on situations in which the underlying intellectual property is subject to change over the licence period.

The key determinant is whether the entity is required to undertake activities that affect the licensed intellectual property (or the customer has a reasonable expectation that the entity will do so) and whether the customer is, therefore, exposed to positive or negative effects resulting from those changes. Furthermore, those activities undertaken by the entity do not meet the definition of a performance obligation. However, these activities can be part of an entity’s ongoing and ordinary activities and customary business practices (i.e., they do not have to be activities the entity is undertaking specifically as a result of the contract with the customer). In addition, the Boards noted, in the Basis for Conclusions, that the existence of a shared economic interest between the parties (e.g., sales or usage-based royalties) may be an indicator that the customer has a reasonable expectation that the entity will undertake such activities.\(^\text{142}\)

\[^{142}\text{IFRS 15.BC413}\]
It is important to note that when an entity is making this assessment, it must exclude the effect of any other performance obligations in the contract. For example, if an entity enters into a contract to license software and provide access to any future upgrades to that software during the licence period, the entity first determines whether the licence and the promise to provide future updates are separate performance obligations. If they are separate, when the entity considers whether it has a contractual (explicit or implicit) obligation to undertake activities to change the software during the licence period, it would exclude any changes and activities associated with the performance obligation to provide future upgrades.

The standard also provides the following application guidance regarding this determination:

**Extract from IFRS 15**

B62. An entity shall disregard the following factors when determining whether a licence provides a right to access the entity’s intellectual property or a right to use the entity’s intellectual property:

(a) Restrictions of time, geographical region or use—those restrictions define the attributes of the promised licence, rather than define whether the entity satisfies its performance obligation at a point in time or over time.

(b) Guarantees provided by the entity that it has a valid patent to intellectual property and that it will defend that patent from unauthorised use—a promise to defend a patent right is not a performance obligation because the act of defending a patent protects the value of the entity’s intellectual property assets and provides assurance to the customer that the licence transferred meets the specifications of the licence promised in the contract.

Following issuance of the revenue standards, stakeholders raised several questions about when and how to apply the licences application guidance. This led to discussions at the TRG meetings in July 2014 and October 2014. TRG members could not reach agreement on the issues discussed. The questions were, therefore, taken to the Boards for further consideration.

At their February 2015 joint meeting, the Boards agreed to propose amendments to their standards to clarify the requirements. However, they did not agree on the nature and extent of all of the changes to propose.

The Boards agreed to clarify the nature of an entity’s promise in granting a licence of intellectual property, which will determine whether the promise is satisfied over time or at a point in time. Both Boards agreed that activities to be performed by the licensor that affect the ‘utility’ of the intellectual property would require the licence to be recognised over time. If the intellectual property has significant stand-alone functionality, the licensor’s activities will not significantly affect the utility of the intellectual property, and revenue would be recognised at a point in time. However, the Boards reached different decisions on how this clarification should be made in their respective standards.
In July 2015, the IASB issued its exposure draft\textsuperscript{143} to propose clarifying that the activities to be performed by the licensor significantly affect the intellectual property if they:

- Change the form or functionality of the intellectual property to which the customer has rights
- Or
- Affect the ability of the customer to obtain benefit from the intellectual property

If the intellectual property has significant stand-alone functionality (i.e., the licensor's activities would not significantly affect the functionality of the intellectual property), revenue would be recognised at a point in time.

In May 2015, the FASB issued its proposal to clarify how an entity would determine the nature of its promise in granting a licence of intellectual property, which would determine whether the promise is satisfied over time or at a point in time. The FASB determined that past or ongoing activities performed by the licensor that affect the intellectual property's 'utility' (i.e., the intellectual property's ability to provide benefits or value) would require the revenue from the licence to be recognised over time. If the intellectual property has significant stand-alone functionality, the licensor's past or ongoing activities will not significantly affect the utility of the intellectual property and revenue would be recognised at a point in time.

The FASB's proposal would require entities to classify intellectual property in one of two categories:

- **Functional**: This intellectual property would have stand-alone functionality (e.g., many types of software, completed media content such as films, television shows and music). Revenue for these licences would be recognised at the point in time, when the intellectual property is made available for the customer's use and benefit, if the functionality is not expected to change substantially as a result of the licensor's ongoing activities that do not otherwise transfer a good or service to the customer. If the functionality is expected to change, and the customer will be required, or compelled, to use the latest version of the intellectual property, revenue for the licence would be recognised over time.

- **Symbolic**: This intellectual property would not have significant stand-alone functionality (e.g., brands, team and trade names, character images). The utility of symbolic intellectual property would be derived from the licensor's ongoing or past support (e.g., activities that support the value of character images licensed from an animated film). Revenue from these licences would be recognised over time as the performance obligation is satisfied (e.g., over the licence period)

\textsuperscript{143} Exposure draft ED/2015/6, *Clarifications to IFRS 15* issued by the IASB in July 2015
The FASB also proposed clarifying that:

- An entity would need to apply the licences application guidance for a bundled performance obligation comprising a licence of intellectual property and other goods or services to help determine the nature of the promise in granting the licence and, therefore, the pattern of revenue recognition for the overall performance obligation.

- Contractual restrictions on use (e.g., limits on the use of licensed intellectual property during certain windows of time) are attributes of a licence that define the scope of a customer’s rights under the licence, but they do not affect the identification of promised goods or services. However, some contractual provisions may not be considered contractual restrictions for purposes of applying the licences application guidance.

In deciding not to propose the same amendments as the FASB, the IASB indicated that IFRS 15 (including its Basis for Conclusions) and public discussions of these topics at this meeting, as well as the meetings of the TRG, provide sufficient guidance on these matters and no clarification was necessary.

During their February 2015 discussions, the Boards agreed that both of their approaches would generally result in consistent answers in most transactions. However, the alternatives may result in differences between IFRS and US GAAP when entities licence brand names that no longer have any related ongoing activities. Under the IASB approach, revenue would be recognised at a point in time if there are no ongoing activities. Under the FASB approach, a licence of a brand name would be classified as symbolic intellectual property and revenue would be recognised over time, regardless of whether there are any related ongoing activities. FASB members commented that this approach would be more operational and less costly for entities to apply.

8.4.3 Transfer of control of licensed intellectual property

Based on whether the nature of the entity’s promise is a right to access or a right to use the intellectual property, the contract consideration allocated to the licensed intellectual property would be recognised over the licence period (for a right to access) or at the point in time the customer can first use the licensed intellectual property (for a right to use).

**Right to access**

The Boards concluded that a licence that provides an entity with the right to access intellectual property is satisfied over time “because the customer simultaneously receives and consumes the benefit from the entity’s performance as the performance occurs”, including the related activities undertaken by entity. This conclusion is based on the determination that when a licence is subject to change (and the customer is exposed to the positive or negative effects of that change), the customer is not able to fully gain control over the intellectual property at any given point in time, but rather gains control over the licence period.

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144 Exposure draft ED/2015/6, Clarifications to IFRS 15 issued by the IASB in July 2015
145 FASB Proposed ASU, Revenue from Contracts with Customers – Identifying Performance Obligations and Licensing, May 2015
146 IFRS 15.BC414
The standard includes the following example of a right-to-access licence. In July 2015, the IASB proposed clarifications to this example, but these have not been reflected in the text below:

**Extract from IFRS 15**

**Example 58 – Access to intellectual property (IFRS 15.IE297-IE302)**

An entity, a creator of comic strips, licenses the use of the images and names of its comic strip characters in three of its comic strips to a customer for a four-year term. There are main characters involved in each of the comic strips. However, newly created characters appear regularly and the images of the characters evolve over time. The customer, an operator of cruise ships, can use the entity's characters in various ways, such as in shows or parades, within reasonable guidelines. The contract requires the customer to use the latest images of the characters.

In exchange for granting the licence, the entity receives a fixed payment of C$1 million in each year of the four-year term.

In accordance with paragraph 27 of IFRS 15, the entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity concludes that it has no other performance obligations other than the promise to grant a licence. That is, the additional activities associated with the licence do not directly transfer a good or service to the customer because they are part of the entity's promise to grant a licence and, in effect, change the intellectual property to which the customer has rights.

The entity assesses the nature of the entity's promise to transfer the licence in accordance with paragraph B58 of IFRS 15. In assessing the criteria the entity considers the following:

(a) the customer reasonably expects (arising from the entity's customary business practices) that the entity will undertake activities that will affect the intellectual property to which the customer has rights (i.e., the characters). Those activities include development of the characters and the publishing of a weekly comic strip that includes the characters.

(b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities because the contract requires the customer to use the latest characters.

(c) even though the customer may benefit from those activities through the rights granted by the licence, they do not transfer a good or service to the customer as those activities occur.

Consequently, the entity concludes that the criteria in paragraph B58 of IFRS 15 are met and that the nature of the entity's promise to transfer the licence is to provide the customer with access to the entity's intellectual property as it exists throughout the licence period. Consequently, the entity accounts for the promised licence as a performance obligation satisfied over time (i.e., the criterion in paragraph 35(a) of IFRS 15 is met).

The entity applies paragraphs 39-45 of IFRS 15 to identify the method that best depicts its performance in the licence. Because the contract provides the customer with unlimited use of the licensed characters for a fixed term, the entity determines that a time-based method would be the most appropriate measure of progress towards complete satisfaction of the performance obligation.
**Right to use**

In contrast, when the licence represents a right to use the intellectual property as it exists at a specific point in time, the customer gains control over that intellectual property at the beginning of the period for which it has the right to use the intellectual property. This timing may differ from when the licence was granted. For example, an entity may provide a customer with the right to use intellectual property, but indicate that right to use does not start until 30 days after the agreement is finalised. For the purpose of determining when control transfers for rights to use, the Boards were clear that the assessment is from the customer’s perspective (i.e., when the customer can use the licensed intellectual property), rather than the entity’s perspective (i.e., when the entity transfers the licence).

The standard includes the following example of a right-to-use licence. In July 2015, the IASB proposed clarifications to this example, but these have not been reflected in the text below:

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**Extract from IFRS 15**

**Example 59 — Right to use intellectual property (IFRS 15.IE303-IE306)**

An entity, a music record label, licenses to a customer a 1975 recording of a classical symphony by a noted orchestra. The customer, a consumer products company, has the right to use the recorded symphony in all commercials, including television, radio and online advertisements for two years in Country A. In exchange for providing the licence, the entity receives fixed consideration of CU10,000 per month. The contract does not include any other goods or services to be provided by the entity. The contract is non-cancellable.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of IFRS 15. The entity concludes that its only performance obligation is to grant the licence.

In accordance with paragraph B58 of IFRS 15, the entity assesses the nature of the entity’s promise to grant the licence. The entity does not have any contractual or implied obligations to change the licensed recording. Thus, the intellectual property to which the customer has rights is static. Consequently, the entity concludes that the nature of its promise in transferring the licence is to provide the customer with a right to use the entity’s intellectual property as it exists at the point in time that it is granted. Therefore, the promise to grant the licence is a performance obligation satisfied at a point in time. The entity recognises all of the revenue at the point in time when the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licensed intellectual property.

Because of the length of time between the entity’s performance (at the beginning of the period) and the customer’s monthly payments over two years (which are non-cancellable), the entity considers the requirements in paragraphs 60–65 of IFRS 15 to determine whether a significant financing component exists.

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147 Exposure draft ED/2015/6, *Clarifications to IFRS 15* issued by the IASB in July 2015
8.4.4 Sales or usage-based royalties on licences of intellectual property

IFRS 15 also provides application guidance on the determination of the transaction price when the contract includes sales or usage-based royalties on licences of intellectual property. The standard requires that this particular type of variable consideration not be included in the estimate of variable consideration, as discussed in Section 5.1, until the subsequent sale or usage has occurred. That is, the standard requires that such amounts be recognised only upon the later of when the sale or usage occurs or the satisfaction (in whole or in part) of performance obligation to which some or all of the sales or usage-based royalty has been allocated.

This application guidance is applicable to all licences of intellectual property, regardless of whether they have been determined to be distinct. However, the application guidance is not applicable to all arrangements involving sales or usage-based royalties. It only applies to sales or usage-based royalties related to licences of intellectual property.

Stakeholders have questioned whether the sales or usage-based royalty exception applies to royalties in contracts in which the licence is not the only promise. For example, a contract may have two performance obligations, one of which is a distinct licence. A licence may also be bundled with another good or service within one performance obligation. In February 2015, the Boards agreed to amend their standards to clarify when the exception for licences of intellectual property that are subject to a sales or usage-based royalty would apply.

The Boards agreed that the sales or usage-based royalty exception would be applied to the overall royalty stream when the predominant item within the arrangement is the licence of intellectual property. The Boards also agreed to amend the standards to clarify that a sales or usage-based royalty in these types of contracts would not be partially within the scope of the exception and partially in the scope of the general variable consideration constraint requirements; an entity would apply one or the other, but not both.

The IASB issued an exposure draft in July 2015 proposing this amendment.\textsuperscript{148} The FASB’s proposed changes were exposed for public comment in May 2015.\textsuperscript{149}

The standard includes the following example relating to sales and usage-based royalties. In July 2015, the IASB proposed clarifications to this example, but these have not been reflected in the text below.\textsuperscript{150}

\textbf{Extract from IFRS 15}

\textit{Example 57 – Franchise rights (IFRS 15.IE289-IE296)}

An entity enters into a contract with a customer and promises to grant a franchise licence that provides the customer with the right to use the entity’s trade name and sell the entity’s products for 10 years. In addition to the licence, the entity also promises to provide the equipment necessary to operate a franchise store. In exchange for granting the licence, the entity receives a sales-based royalty of five per cent of the customer’s monthly sales. The fixed consideration for the equipment is CU150,000 payable when the equipment is delivered.

\textsuperscript{148} Exposure draft ED/2015/6, \textit{Clarifications to IFRS 15} issued by the IASB in July 2015

\textsuperscript{149} FASB Proposed ASU, \textit{Revenue from Contracts with Customers – Identifying Performance Obligations and Licensing}, May 2015

\textsuperscript{150} Exposure draft ED/2015/6, \textit{Clarifications to IFRS 15} issued by the IASB in July 2015
Extract from IFRS 15 (cont’d)

Identifying performance obligations
The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of IFRS 15. The entity observes that the entity, as a franchisor, has developed a customary business practice to undertake activities such as analysing the customer’s changing preferences and implementing product improvements, pricing strategies, marketing campaigns and operational efficiencies to support the franchise name. However, the entity concludes that these activities do not directly transfer goods or services to the customer because they are part of the entity’s promise to grant a licence and, in effect, change the intellectual property to which the customer has rights.

The entity determines that it has two promises to transfer goods or services: a promise to grant a licence and a promise to transfer equipment. In addition, the entity concludes that the promise to grant the licence and the promise to transfer the equipment are distinct. This is because the customer can benefit from each promise (ie the promise of the licence and the promise of the equipment) on their own or together with other resources that are readily available (see paragraph 27(a) of IFRS 15). (That is, the customer can benefit from the licence together with the equipment that is delivered before the opening of the franchise and the equipment can be used in the franchise or sold for an amount other than scrap value.) The entity also determines that the franchise licence and equipment are separately identifiable, in accordance with the criterion in paragraph 27(b) of IFRS 15, because none of the factors in paragraph 29 of IFRS 15 are present. Consequently, the entity has two performance obligations:

(a) the franchise licence; and
(b) the equipment.

Allocating the transaction price
The entity determines that the transaction price includes fixed consideration of CU150,000 and variable consideration (five per cent of customer sales).

The entity applies paragraph 85 of IFRS 15 to determine whether the variable consideration should be allocated entirely to the performance obligation to transfer the franchise licence. The entity concludes that the variable consideration (ie the sales-based royalty) should be allocated entirely to the franchise licence because the variable consideration relates entirely to the entity’s promise to grant the franchise licence. In addition, the entity observes that allocating CU150,000 to the equipment and the sales-based royalty to the franchise licence would be consistent with an allocation based on the entity’s relative stand-alone selling prices in similar contracts. That is, the stand-alone selling price of the equipment is CU150,000 and the entity regularly licences franchises in exchange for five per cent of customer sales.

Consequently, the entity concludes that the variable consideration (ie the sales-based royalty) should be allocated entirely to the performance obligation to grant the franchise licence.
Application guidance: licensing

The entity assesses, in accordance with paragraph B58 of IFRS 15, the nature of the entity’s promise to grant the franchise licence. The entity concludes that the criteria in paragraph B58 of IFRS 15 are met and the nature of the entity’s promise is to provide access to the entity’s intellectual property in its current form throughout the licence period. This is because:

(a) the entity concludes that the customer would reasonably expect that the entity will undertake activities that will affect the intellectual property to which the customer has rights. This is on the basis of the entity’s customary business practice to undertake activities such as analysing the customer’s changing preferences and implementing product improvements, pricing strategies, marketing campaigns and operational efficiencies. In addition, the entity observes that because part of its compensation is dependent on the success of the franchisee (as evidenced through the sales-based royalty), the entity has a shared economic interest with the customer that indicates that the customer will expect the entity to undertake those activities to maximise earnings.

(b) the entity also observes that the franchise licence requires the customer to implement any changes that result from those activities and thus exposes the customer to any positive or negative effects of those activities.

(c) the entity also observes that even though the customer may benefit from the activities through the rights granted by the licence, they do not transfer a good or service to the customer as those activities occur.

Because the criteria in paragraph B58 of IFRS 15 are met, the entity concludes that the promise to transfer the licence is a performance obligation satisfied over time in accordance with paragraph 35(a) of IFRS 15.

The entity also concludes that because the consideration is in the form of a sales-based royalty, the entity applies paragraph B63 of IFRS 15 and, after the transfer of the franchise licence, the entity recognises revenue as and when those sales occur.
9 Presentation and disclosure

IFRS 15 provides explicit presentation and disclosure requirements, which are more detailed than under current IFRS. Furthermore, the interim disclosure requirements for IFRS reporting entities differ from the requirements for entities reporting under US GAAP. These topics are discussed in more detail below.

Note, the disclosure requirements discussed in the following sections are required on an ongoing basis. Disclosures required as part of the transition to IFRS 15 are discussed in Section 1.2.

9.1 Presentation of contract assets, contract liabilities and revenue

IFRS 15 is based on the notion that a contract asset or contract liability is generated when either party to a contract performs. The standard requires 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, the entity has earned a right to consideration from the customer and, therefore, has a contract asset. When the customer performs first, for example, by prepaying its promised consideration, the entity has a contract liability.

In many cases, the entity has an unconditional right to receive the consideration from the customer. This is the case when there are no further performance obligations required to be satisfied before the entity has the right to collect the customer’s consideration. The Boards concluded that an unconditional right to receive the customer’s consideration represents a receivable from the customer that is classified separately from contract assets. A right is unconditional if nothing other than the passage of time is required before payment of that consideration is due.

Contract assets exist when an entity has satisfied a performance obligation but does not yet have an unconditional right to consideration (e.g., because the entity first must satisfy another performance obligation in the contract before it is entitled to invoice the customer).

Under IFRS 15, entities are not required to use the terms ‘contract asset’ or ‘contract liability’, but must disclose sufficient information so that users of the financial statements can clearly distinguish between unconditional rights to consideration (receivables) and conditional rights to receive consideration (contract assets).

After initial recognition, receivables and contract assets are subject to an impairment assessment in accordance with IFRS 9 or IAS 39. In addition, if upon initial measurement there is a difference between the measurement of the receivable under IFRS 9 or IAS 39 and the corresponding amount of revenue, that difference will be presented immediately in profit or loss (e.g., as an impairment loss). Since the initial measurement of a financial instrument is at fair value, there may be a number of reasons why such differences may arise (e.g., changes in the fair value of non-cash consideration). Based on the discussion in Section 5.1.1 (regarding how collectability is considered when determining the transaction price), there may be a difference between the measurement of the receivable and the corresponding revenue when an entity determines that customer credit risk does not reflect an implied price concession. Impairment losses resulting from contracts with customers are presented separately from other impairment losses.
An entity could also have recorded other assets (e.g., the incremental costs of obtaining the contract and other costs incurred that meet the criteria for capitalisation). The standard requires that any such assets be presented separately from contract assets and contract liabilities in the statement of financial position (assuming that they are material). These amounts are also assessed for impairment separately (see Section 8.3.3).

The standard also requires revenue from contracts with customers be presented or disclosed separately from the entity's other sources of revenue. For example, a large equipment manufacturer that both sells and leases its equipment will present amounts from these transactions separately.

How we see it

The presentation requirements in IFRS 15 represent a significant change from current practice. In addition, applying the notion of a contract asset, and any impairment of that asset, may generate questions.

Summary of recent TRG discussions

<table>
<thead>
<tr>
<th>Implementation questions on presentation of contract assets and liabilities</th>
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<tbody>
<tr>
<td>a) Determining the presentation of contract assets and liabilities for contracts that contain multiple performance obligations</td>
</tr>
<tr>
<td>At the October 2014 TRG meeting, members of the TRG were asked how an entity would determine the presentation of contract assets and liabilities for contracts that contain multiple performance obligations. 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).</td>
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b) Determining the presentation of two or more contracts that are required to be combined under the standards

At the October 2014 TRG meeting, members of the TRG considered how an entity would determine the presentation of two or more contracts that are required to be combined under the standards. 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.

c) Offsetting contract assets and liabilities against other balance sheet items (e.g., accounts receivable)

At the October 2014 TRG meeting, members of the TRG considered when an entity would offset contract assets and liabilities against other balance sheet items (e.g., accounts receivable). 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 1, IAS 32 Financial Instruments: Presentation) to determine whether offsetting is appropriate.
9.2 Disclosure objective and general requirements

In response to criticism that the current revenue recognition disclosures are inadequate, the Boards sought to create a comprehensive and coherent set of disclosures. As a result, and to be consistent with other recent standards, IFRS 15 includes an overall objective for these disclosures, as follows:

<table>
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<th>Extract from IFRS 15</th>
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<tbody>
<tr>
<td>110. The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity shall disclose qualitative and quantitative information about all of the following:</td>
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<td>(a) its contracts with customers (see paragraphs 113-122);</td>
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<tr>
<td>(b) the significant judgements, and changes in the judgements, made in applying this Standard to those contracts (see paragraphs 123-126); and</td>
</tr>
<tr>
<td>(c) any assets recognised from the costs to obtain or fulfil a contract with a customer in accordance with paragraph 91 or 95 (see paragraphs 127-128).</td>
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Each of these disclosure requirements is discussed further below. To assist entities in determining the required disclosures, Appendix A includes an extract from EY’s IFRS Disclosure Checklist.

During the development of IFRS 15, many preparers raised concerns that they would need to provide voluminous disclosures at a cost that may outweigh any potential benefits. In the standard, the Boards clarified the disclosure objective and indicated that the disclosures described in the standard are not meant to be a checklist of minimum requirements. That is, entities do not need to include disclosures that are not relevant or are not material to them. In addition, the Boards decided to require qualitative disclosures instead of tabular reconciliations for certain disclosures.

The disclosures are required for (and as at) each annual period for which a statement of comprehensive income and a statement of financial position are presented. Interim disclosures are also required for entities preparing interim financial statements, although the required interim disclosures will differ under IFRS and US GAAP. While the IASB amended IAS 34 *Interim Financial Reporting* to require disaggregated revenue information, none of the other annual disclosures will be required in the interim financial statements for IFRS preparers. The FASB amended ASC 270 *Interim Reporting* to require the same quantitative disclosures about revenue in interim financial statements as in the annual financial statements.
How we see it

As discussed more fully below, IFRS 15 significantly increases the volume of disclosures required in entities’ financial statements, particularly annual financial statements. In addition, many are completely new requirements.

We believe entities may need to expend additional effort when initially preparing the required disclosures for their interim and annual financial statements. For example, entities operating in multiple segments with many different product lines may find it challenging to gather the data needed to provide the disclosures. As a result, entities will need to ensure that they have the appropriate systems, internal controls, policies and procedures in place to collect and disclose the required information. In light of the expanded disclosure requirements and the potential need for new systems to capture the data needed for these disclosures, entities may wish to prioritise this portion of their implementation plans.

9.3 Specific disclosure requirements
9.3.1 Contracts with customers
The majority of the disclosures relate to an entity’s contracts with customers. These disclosures include disaggregation of revenue, information about contract asset and liability balances and information about an entity’s performance obligations.

Disaggregation of revenue
The disclosure requirements begin with revenue disaggregated into categories to illustrate how the nature, amount, timing and uncertainty about revenue and cash flows are affected by economic factors. This is the only disclosure requirement for IFRS preparers that is required in both an entity’s interim and annual financial statements.

While the standard does not specify precisely how revenue should be disaggregated, the application guidance suggests categories, as follows:

Extract from IFRS 15

B89. Examples of categories that might be appropriate include, but are not limited to, all of the following:

(a) type of good or service (for example, major product lines);
(b) geographical region (for example, country or region);
(c) market or type of customer (for example, government and non-government customers);
(d) type of contract (for example, fixed-price and time-and-materials contracts);
(e) contract duration (for example, short-term and long-term contracts);
(f) timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time); and
(g) sales channels (for example, goods sold directly to consumers and goods sold through intermediaries).
The application guidance indicates that the most appropriate categories for a particular entity will depend on the facts and circumstances, but an entity considers how it disaggregates revenue in other communications (e.g., press releases, other public filings) when determining which categories are most relevant and useful.

The Boards decided not to prescribe a specific characteristic of revenue as the basis for disaggregation because they intend for entities to make this determination based on entity-specific and/or industry-specific factors that would be most meaningful for their businesses. The Boards acknowledged that an entity may need to use more than one type of category to disaggregate its revenue.

The Boards also clarified that an entity does not have to duplicate disclosures required by another standard. For example, an entity that provides disaggregated revenue disclosures as part of its segment disclosures, in accordance with IFRS 8 Operating Segments, does not need to separately provide disaggregated revenue disclosures if the segment-related disclosures are sufficient to illustrate how the nature, amount, timing and uncertainty about revenue and cash flows are affected by economic factors and are presented on a basis consistent with IFRS. However, if separate disaggregated revenue disclosures are provided, the standard requires an entity to explain the relationship between the disaggregated revenue information and the segment information. Users of the financial statements believe this information is critical to their ability to understand not only the composition of revenue, but also how revenue relates to other information provided in the segment disclosures. Entities can provide this information in a tabular or a narrative form.

Unless presented separately in the statement of comprehensive income in accordance with another IFRS, an entity is required to disclose any impairment losses recognised in accordance with IFRS 9 or IAS 39 on receivables or contract assets arising from contracts with customers. Those losses must be disclosed separately from impairment losses from other contracts. However, entities are not required to further disaggregate such losses.

The Boards provided some examples of disaggregation of revenue, as follows:

**Extract from IFRS 15**

**Example 41 — Disaggregation of revenue—quantitative disclosure (IFRS 15.IE210-IE211)**

An entity reports the following segments: consumer products, transportation and energy, in accordance with IFRS 8 Operating Segments. When the entity prepares its investor presentations, it disaggregates revenue into primary geographical markets, major product lines and timing of revenue recognition (i.e., goods transferred at a point in time or services transferred over time).

The entity determines that the categories used in the investor presentations can be used to meet the objective of the disaggregation disclosure requirement in paragraph 114 of IFRS 15, which is to disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. The following table illustrates the disaggregation disclosure by primary geographical market, major product line and timing of revenue recognition, including a reconciliation of how the disaggregated revenue ties in with the consumer products, transportation and energy segments, in accordance with paragraph 115 of IFRS 15.
### Extract from IFRS 15 (cont’d)

<table>
<thead>
<tr>
<th>Segments</th>
<th>Consumer products</th>
<th>Transport</th>
<th>Energy</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CU</td>
<td>CU</td>
<td>CU</td>
<td>CU</td>
</tr>
<tr>
<td><strong>Primary geographical markets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North America</td>
<td>990</td>
<td>2,250</td>
<td>5,250</td>
<td>8,490</td>
</tr>
<tr>
<td>Europe</td>
<td>300</td>
<td>750</td>
<td>1,000</td>
<td>2,050</td>
</tr>
<tr>
<td>Asia</td>
<td>700</td>
<td>260</td>
<td>-</td>
<td>960</td>
</tr>
<tr>
<td></td>
<td>1,990</td>
<td>3,260</td>
<td>6,250</td>
<td>11,500</td>
</tr>
<tr>
<td><strong>Major goods/service lines</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office Supplies</td>
<td>600</td>
<td>-</td>
<td>-</td>
<td>600</td>
</tr>
<tr>
<td>Appliances</td>
<td>990</td>
<td>-</td>
<td>-</td>
<td>990</td>
</tr>
<tr>
<td>Clothing</td>
<td>400</td>
<td>-</td>
<td>-</td>
<td>400</td>
</tr>
<tr>
<td>Motorcycles</td>
<td>-</td>
<td>500</td>
<td>-</td>
<td>500</td>
</tr>
<tr>
<td>Automobiles</td>
<td>-</td>
<td>2,760</td>
<td>-</td>
<td>2,760</td>
</tr>
<tr>
<td>Solar Panels</td>
<td>-</td>
<td>-</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Power Plant</td>
<td>-</td>
<td>-</td>
<td>5,250</td>
<td>5,250</td>
</tr>
<tr>
<td></td>
<td>1,990</td>
<td>3,260</td>
<td>6,250</td>
<td>11,500</td>
</tr>
<tr>
<td><strong>Timing of revenue recognition</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goods transferred at a point in time</td>
<td>1,990</td>
<td>3,260</td>
<td>1,000</td>
<td>6,250</td>
</tr>
<tr>
<td>Services transferred over time</td>
<td>-</td>
<td>-</td>
<td>5,250</td>
<td>5,250</td>
</tr>
<tr>
<td></td>
<td>1,990</td>
<td>3,260</td>
<td>6,250</td>
<td>11,500</td>
</tr>
</tbody>
</table>

### Contract balances

The Boards concluded that users of the financial statements need to understand the relationship between the revenue recognised and changes in the overall balances of an entity’s total contract assets and liabilities during a particular reporting period. As a result, the Boards included the following disclosure requirements for an entity’s contracts with its customers:

#### Extract from IFRS 15

116. An entity shall disclose all of the following:

   (a) the opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed;

   (b) revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period; and

   (c) revenue recognised in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (for example, changes in transaction price).

117. An entity shall explain how the timing of satisfaction of its performance obligations (see paragraph 119(a)) relates to the typical timing of payment (see paragraph 119(b)) and the effect that those factors have on the contract asset and the contract liability balances. The explanation provided may use qualitative information.
Extract from IFRS 15 (cont’d)

118. An entity shall provide an explanation of the significant changes in the contract asset and the contract liability balances during the reporting period. The explanation shall include qualitative and quantitative information. Examples of changes in the entity’s balances of contract assets and contract liabilities include any of the following:

(a) changes due to business combinations;
(b) cumulative catch-up adjustments to revenue that affect the corresponding contract asset or contract liability, including adjustments arising from a change in the measure of progress, a change in an estimate of the transaction price (including any changes in the assessment of whether an estimate of variable consideration is constrained) or a contract modification;
(c) impairment of a contract asset;
(d) a change in the time frame for a right to consideration to become unconditional (ie for a contract asset to be reclassified to a receivable); and
(e) a change in the time frame for a performance obligation to be satisfied (ie for the recognition of revenue arising from a contract liability).

The requirements listed above will likely be new for most entities. The illustration below is an example of how an entity may fulfil these requirements:

Illustration 9-1 — Disclosure of contract balances

Company A discloses trade receivables separately in the statement of financial position. In order to comply with the remainder of the required disclosures pertaining to contract assets and liabilities, Company A includes the following information in the notes to the financial statements:

<table>
<thead>
<tr>
<th>Year</th>
<th>Contract asset</th>
<th>Contract liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X9</td>
<td>CU1,500</td>
<td>CU(200)</td>
</tr>
<tr>
<td>20X8</td>
<td>CU2,250</td>
<td>CU(850)</td>
</tr>
<tr>
<td>20X7</td>
<td>CU1,800</td>
<td>CU(500)</td>
</tr>
</tbody>
</table>

Revenue recognised in the period from:

- Amounts included in contract liability at the beginning of the period: CU650, CU200, CU100
- Performance obligations satisfied in previous periods: CU200, CU125, CU200

We receive payments from customers based on a billing schedule, as established in our contracts. The contract asset relates to costs incurred to perform in advance of scheduled billing. The contract liability relates to payments received in advance of performance under the contract. Changes in the contract asset and liability are due to our performance under the contract. In addition, a contract asset decreased in 20X9 due to a contract asset impairment of CU400 relating to an early cancellation of a contract with a customer.
Performance obligations

To help users of financial statements analyse the nature, amount, timing and uncertainty about revenue and cash flows arising from contracts with customers, the Boards decided to require a separate disclosure of an entity’s remaining performance obligations. An entity is also required to disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when it expects to recognise the amount(s).

Both quantitative and qualitative information is required, as follows:

**Extract from IFRS 15**

**Performance obligations**

119. An entity shall disclose information about its performance obligations in contracts with customers, including a description of all of the following:

(a) when the entity typically satisfies its performance obligations (for example, upon shipment, upon delivery, as services are rendered or upon completion of service), including when performance obligations are satisfied in a bill-and-hold arrangement;

(b) the significant payment terms (for example, when payment is typically due, whether the contract has a significant financing component, whether the consideration amount is variable and whether the estimate of variable consideration is typically constrained in accordance with paragraphs 56–58);

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

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

(e) types of warranties and related obligations.

**Transaction price allocated to the remaining performance obligations**

120. An entity shall disclose the following information about its remaining performance obligations:

(a) the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period; and

(b) an explanation of when the entity expects to recognise as revenue the amount disclosed in accordance with paragraph 120(a), which the entity shall disclose in either of the following ways:

(i) on a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations; or

(ii) by using qualitative information.

In the Basis for Conclusions, the Boards noted that, during development of the standard, many users of financial statements commented that information about the amount and timing of revenue that an entity expects to recognise from its existing contracts would be useful in their analysis of revenue. In particular, users were interested in information related to long-term contracts with significant unrecognised revenue. The Boards also observed that a number

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151 IFRS 15.BC348
of entities often voluntarily disclose such ‘backlog’ information. However, this information is typically presented outside the financial statements and may not be comparable across entities because there is no common definition of backlog. As summarised in the Basis for Conclusions, the Boards’ intention in including the disclosure requirements in IFRS 15.120 is to provide users of an entity’s financial statements with additional information about the following:

“(a) the amount and expected timing of revenue to be recognised from the remaining performance obligations in existing contracts;
(b) trends relating to the amount and expected timing of revenue to be recognised from the remaining performance obligations in existing contracts;
(c) risks associated with expected future revenue (for example, some observe that revenue is more uncertain if an entity does not expect to satisfy a performance obligation until a much later date); and
(d) the effect of changes in judgements or circumstances on an entity’s revenue.”

This disclosure can be provided on either a quantitative basis (e.g., amounts to be recognised in given time bands, such as between one and two years or between two and three years) or by disclosing a mix of quantitative and qualitative information. This disclosure does not include consideration attributable to contract renewal options that do not represent a material right and any estimated amounts of variable consideration that are constrained and, therefore, not included in the transaction price. However, any significant renewals and variable consideration not included in the estimate of the transaction price must be qualitatively disclosed.

The Boards also provided a practical expedient under which an entity can avoid disclosing the amount of the remaining performance obligations for contracts with an original expected duration of less than one year or those that meet the requirements of the right to invoice practical expedient (see a summary of the recent TRG’s discussions in Section 7.1.4 above) that permits the entity to recognise revenue as invoiced. For example, an entity is not required to make the disclosure for a three-year service contract under which it has a right to invoice the customer a fixed amount for each hour of service provided. If an entity uses this disclosure practical expedient, it will be required to qualitatively disclose that fact.

The standard provides the following examples for these required disclosures:

**Extract from IFRS 15**

**Example 42 – Disclosure of the transaction price allocated to the remaining performance obligations (IFRS 15.IE212-IE219)**

On 30 June 20X7, an entity enters into three contracts (Contracts A, B and C) with separate customers to provide services. Each contract has a two-year non-cancellable term. The entity considers the requirements in paragraphs 120-122 of IFRS 15 in determining the information in each contract to be included in the disclosure of the transaction price allocated to the remaining performance obligations at 31 December 20X7.

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152 IFRS 15.BC350
153 IFRS 15.121
154 IFRS 15.122
Extract from IFRS 15 (cont’d)

Contract A
Cleaning services are to be provided over the next two years typically at least once per month. For services provided, the customer pays an hourly rate of CU25.

Because the entity bills a fixed amount for each hour of service provided, the entity has a right to invoice the customer in the amount that corresponds directly with the value of the entity’s performance completed to date in accordance with paragraph B16 of IFRS 15. Consequently, no disclosure is necessary if the entity elects to apply the practical expedient in paragraph 121(b) of IFRS 15.

Contract B
Cleaning services and lawn maintenance services are to be provided as and when needed with a maximum of four visits per month over the next two years. The customer pays a fixed price of CU400 per month for both services. The entity measures its progress towards complete satisfaction of the performance obligation using a time-based measure.

The entity discloses the amount of the transaction price that has not yet been recognised as revenue in a table with quantitative time bands that illustrates when the entity expects to recognise the amount as revenue. The information for Contract B included in the overall disclosure is as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>20X8</th>
<th>20X9</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>CU</td>
<td>CU</td>
<td>CU</td>
<td></td>
</tr>
<tr>
<td>Revenue expected to be recognised on this contract as of 31 December 20X7</td>
<td>4,800(a)</td>
<td>2,400(b)</td>
<td>7,200</td>
</tr>
<tr>
<td>(a) CU4,800 = CU400 × 12 months.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) CU2,400 = CU400 × 6 months.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Contract C
Cleaning services are to be provided as and when needed over the next two years. The customer pays fixed consideration of CU100 per month plus a one-time variable consideration payment ranging from CU0–CU1,000 corresponding to a one-time regulatory review and certification of the customer’s facility (ie a performance bonus). The entity estimates that it will be entitled to CU750 of the variable consideration. On the basis of the entity’s assessment of the factors in paragraph 57 of IFRS 15, the entity includes its estimate of CU750 of variable consideration in the transaction price because it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. The entity measures its progress towards complete satisfaction of the performance obligation using a time-based measure.

The entity discloses the amount of the transaction price that has not yet been recognised as revenue in a table with quantitative time bands that illustrates when the entity expects to recognise the amount as revenue. The entity also includes a qualitative discussion about any significant variable consideration that is not included in the disclosure. The information for Contract C included in the overall disclosure is as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>20X8</th>
<th>20X9</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>CU</td>
<td>CU</td>
<td>CU</td>
<td></td>
</tr>
<tr>
<td>Revenue expected to be recognised on this contract as of 31 December 20X7</td>
<td>1,575(a)</td>
<td>788(b)</td>
<td>2,363</td>
</tr>
<tr>
<td>(a) Transaction price = CU3,150 (CU100 × 24 months + CU750 variable consideration) recognised evenly over 24 months at CU1,575 per year.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) CU1,575 ÷ 2 = CU788 (ie for 6 months of the year).</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
In addition, in accordance with paragraph 122 of IFRS 15, the entity discloses qualitatively that part of the performance bonus has been excluded from the disclosure because it was not included in the transaction price. That part of the performance bonus was excluded from the transaction price in accordance with the requirements for constraining estimates of variable consideration.

Example 43 – Disclosure of the transaction price allocated to the remaining performance obligations—qualitative disclosure (IFRS 15.IE220-IE221)

On 1 January 20X2, an entity enters into a contract with a customer to construct a commercial building for fixed consideration of CU10 million. The construction of the building is a single performance obligation that the entity satisfies over time. As of 31 December 20X2, the entity has recognised CU3.2 million of revenue. The entity estimates that construction will be completed in 20X3, but it is possible that the project will be completed in the first half of 20X4.

At 31 December 20X2, the entity discloses the amount of the transaction price that has not yet been recognised as revenue in its disclosure of the transaction price allocated to the remaining performance obligations. The entity also discloses an explanation of when the entity expects to recognise that amount as revenue. The explanation can be disclosed either on a quantitative basis using time bands that are most appropriate for the duration of the remaining performance obligation or by providing a qualitative explanation. Because the entity is uncertain about the timing of revenue recognition, the entity discloses this information qualitatively as follows:

‘As of 31 December 20X2, the aggregate amount of the transaction price allocated to the remaining performance obligation is CU6.8 million and the entity will recognise this revenue as the building is completed, which is expected to occur over the next 12–18 months.’

9.3.2 Significant judgements

The standard specifically requires disclosure of significant accounting estimates and judgements made in determining the transaction price, allocating the transaction price to performance obligations and determining when performance obligations are satisfied. These requirements exceed those in the general requirements for significant judgements and accounting estimates required by IAS 1 and are discussed in more detail below.\(^\text{155}\)

**Determining the transaction price and the amounts allocated to performance obligations**

Entities often exercise significant judgement when estimating the transaction prices of their contracts, especially when those estimates involve variable consideration.

\(^{155}\) See IAS 1.122-133.
Furthermore, significant judgement may be required when estimating stand-alone selling prices. The standard requires entities to disclose qualitative information about the methods, inputs and assumptions used in their annual financial statements. The Boards concluded this was important so that users can assess the quality of earnings.

**Extract from IFRS 15**

126. An entity shall disclose information about the methods, inputs and assumptions used for all of the following:

   (a) determining the transaction price, which includes, but is not limited to, estimating variable consideration, adjusting the consideration for the effects of the time value of money and measuring non-cash consideration;

   (b) assessing whether an estimate of variable consideration is constrained;

   (c) allocating the transaction price, including estimating stand-alone selling prices of promised goods or services and allocating discounts and variable consideration to a specific part of the contract (if applicable); and

   (d) measuring obligations for returns, refunds and other similar obligations.

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**Determining when performance obligations are satisfied**

The standard also requires entities to provide disclosures about the significant judgements made in determining when performance obligations are satisfied. For performance obligations that are satisfied over time, entities must disclose the following information, as described in the standard:

**Extract from IFRS 15**

124. For performance obligations that an entity satisfies over time, an entity shall disclose both of the following:

   (a) the methods used to recognise revenue (for example, a description of the output methods or input methods used and how those methods are applied); and

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

For performance obligations that are satisfied at a point in time, entities must disclose the significant judgements made in evaluating the point in time when the customer obtains control of the goods or services.

**9.3.3 Assets recognised from the costs to obtain or fulfil a contract**

The standard requires entities to disclose information about assets recognised from the costs to obtain or fulfil a contract. This information is intended to help users understand the types of costs recognised as assets and how those assets are subsequently amortised or impaired. These disclosures are:
Extract from IFRS 15

127. An entity shall describe both of the following:

(a) the judgements made in determining the amount of the costs incurred to obtain or fulfil a contract with a customer (in accordance with paragraph 91 or 95); and

(b) the method it uses to determine the amortisation for each reporting period.

128. An entity shall disclose all of the following:

(a) the closing balances of assets recognised from the costs incurred to obtain or fulfil a contract with a customer (in accordance with paragraph 91 or 95), by main category of asset (for example, costs to obtain contracts with customers, pre-contract costs and setup costs); and

(b) the amount of amortisation and any impairment losses recognised in the reporting period.

9.3.4 Practical expedients

The standard allows entities to use several practical expedients. Applying these practical expedients may lead to financial results that are different from a full application of the standard. As such, entities are required to disclose their use of practical expedients in their annual financial statements in the year of adoption and thereafter. For example, if an entity elects to use the practical expedient associated with the determination of whether a significant financing component exists (see Section 5.3) or the expedient pertaining to the incremental costs of obtaining a customer (see Section 8.3.1), the entity must disclose those facts.
Appendix A: Extract from EY’s IFRS Disclosure Checklist

**IFRS 15 Revenue from Contracts with Customers**

IFRS 15 Revenue from Contracts with Customers was issued in May 2014. It applies to all contracts with customers, with limited exceptions.

IFRS 15 is effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted.

**Transition to IFRS 15**

An entity adopts IFRS 15 using one of the following two methods:

a. Retrospectively to each prior reporting period presented in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, subject to the expedients in IFRS 15.C5

Or

b. Retrospectively with the cumulative effect of initially applying IFRS 15 recognised at the date of initial application in accordance with IFRS 15.C7-C8

For the purposes of the transition requirements:

a. The date of initial application is the start of the reporting period in which an entity first applies IFRS 15

b. A completed contract is a contract for which the entity has transferred all of the goods or services identified in accordance with IAS 11 Construction Contracts, IAS 18 Revenue and related Interpretations

**IFRS 15.C3**

If the entity applies IFRS 15 in its first annual IFRS financial statements for a period beginning before 1 January 2018, does the entity disclose that fact

<table>
<thead>
<tr>
<th>Disclosure made</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Full retrospective approach**

If IFRS 15 is applied retrospectively in accordance with IFRS 15.C3(a), does the entity disclose the adjustment to the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts for each prior period presented as if the entity had always applied the new accounting policy

<table>
<thead>
<tr>
<th>IFRS 15.C3(a)</th>
<th>IAS 8.22</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

If the initial application of IFRS 15 has an effect on the current period or any prior period presented or might have an effect on future periods, unless it is impracticable to determine the amount of the adjustment, does the entity disclose:

a. The title of the IFRS

b. That the change in accounting policy is in accordance with its transitional provisions, if applicable

c. The nature of the change in accounting policy

d. The transitional provisions, if applicable

e. The transitional provisions that might have an effect on future periods, if applicable

f. The adjustment for each financial statement line item affected and the basic and diluted earnings per share for the annual period immediately preceding the first annual period for which IFRS 15 is applied, to the extent practicable (if IAS 33 applies to the entity)

<table>
<thead>
<tr>
<th>IAS 8.28</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notwithstanding the requirements of IAS 8.28, when IFRS 15 is first applied, an entity need only present the quantitative information required by IAS 8.28(f) for the annual period immediately preceding the first annual period for which IFRS 15 is applied (the ‘immediately preceding period’) and only if the entity applies IFRS 15 retrospectively in accordance with IFRS 15.C3(a). An entity may also present this information for the current period or for earlier comparative periods, but is not required to do so.

<table>
<thead>
<tr>
<th>IFRS 15.C4</th>
<th>IAS 8.28(f)</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

g. The amount of the adjustment relating to periods before those presented, to the extent practicable

h. If retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
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</tbody>
</table>

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**Financial statements of subsequent periods need not repeat these disclosures.**

Does the entity disclose the following for any of the practical expedients in IFRS 15.C5 that it uses:

a. The expedients that have been used  

b. To the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients

<table>
<thead>
<tr>
<th>IFRS 15.C5</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
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</tbody>
</table>

An entity may use one or more of the following practical expedients when applying IFRS 15 retrospectively under IFRS 15.C3(a):

a. For completed contracts, an entity need not restate contracts that begin and end within the same annual reporting period.

b. For completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.

c. For all reporting periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue.

<table>
<thead>
<tr>
<th>IFRS 15.C8</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
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<tbody>
<tr>
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</tbody>
</table>

**Modified retrospective approach**

If IFRS 15 is applied retrospectively in accordance with IFRS 15.C3(b), for reporting periods that include the date of initial application does the entity provide both of the following:

a. The amount by which each financial statement line item is affected in the current reporting period by the application of IFRS 15 as compared to IAS 11, IAS 18 and related Interpretations that were in effect before the change

b. An explanation of the reasons for significant changes identified in IFRS 15.C8(a)

<table>
<thead>
<tr>
<th>IFRS 15.C7</th>
<th>Yes</th>
<th>No</th>
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<tbody>
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</table>

**First-time adopter of IFRS**

If a first-time adopter of IFRS applies IFRS 15 on transition to IFRS, does the entity disclose the following for any of the practical expedients in IFRS 15.C5 that the entity uses:

a. The expedients that have been used

b. To the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients

<table>
<thead>
<tr>
<th>IFRS 15.C8</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
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<tbody>
<tr>
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</table>

**Presentation**

A receivable is an entity’s right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future. An entity must account for a receivable in accordance with IFRS 9 or IAS 39, as applicable.

<table>
<thead>
<tr>
<th>IFRS 15.105</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
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<table>
<thead>
<tr>
<th>IFRS 15.108</th>
<th>Yes</th>
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<tbody>
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</table>

**Disclosure made**

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
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</table>
### IFRS 15

#### 15.110

If the entity uses an alternative description for a contract asset, does the entity provide sufficient information for a user of the financial statements to distinguish between receivables and contract assets?

<table>
<thead>
<tr>
<th>Disclosure made</th>
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<tbody>
<tr>
<td>Yes</td>
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</table>

#### 15.109

IFRS 15 uses the terms 'contract asset' and 'contract liability' but does not prohibit an entity from using alternative descriptions in the statement of financial position for those items.

#### 15.65

The existence of a significant financing component in the contract

Does the entity present the effects of financing (interest revenue or interest expense) separately from revenue from contracts with customers in the statement of comprehensive income?

<table>
<thead>
<tr>
<th>Disclosure made</th>
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</thead>
<tbody>
<tr>
<td>Yes</td>
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</tbody>
</table>

#### 15.65

Interest revenue or interest expense is recognised only to the extent that a contract asset (or receivable) or a contract liability is recognised in accounting for a contract with a customer.

#### 15.825

Sale with a right of return

Does the entity present the asset for an entity’s right to recover products from a customer on settling a refund liability separately from the refund liability?

<table>
<thead>
<tr>
<th>Disclosure made</th>
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<tbody>
<tr>
<td>Yes</td>
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</table>

#### 15.825

An asset recognised for an entity’s right to recover products from a customer on settling a refund liability shall initially be measured by reference to the former carrying amount of the product (for example, inventory) less any expected costs to recover those products (including potential decreases in the value to the entity of returned products). At the end of each reporting period, an entity must update the measurement of the asset arising from changes in expectations about products to be returned.

### Disclosures

#### 15.110

The objective of the disclosure requirements in IFRS 15 is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

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

An entity need not disclose information in accordance with IFRS 15 if it has provided the information in accordance with another standard.

To achieve the disclosure objective stated in IFRS 15.110, does the entity disclose qualitative and quantitative information about all of the following:

a. Its contracts with customers (see IFRS 15.113-122)

b. The significant judgements, and changes in the judgements, made in applying IFRS 15 to those contracts (see IFRS 15.123-126)

c. Any assets recognised from the costs to obtain or fulfil a contract with a customer in accordance with IFRS 15.91 or IFRS 15.95 (see IFRS15.127-128)

#### Contracts with customers

Does the entity disclose all of the following amounts for the reporting period:

a. Revenue recognised from contracts with customers, which the entity must disclose separately from its other sources of revenue

b. Any impairment losses recognised (in accordance with IFRS 9 or IAS 39, as applicable) on any receivables or contract assets arising from the entity’s contracts with customers, separately from impairment losses from other contracts

#### Disaggregation of revenue

Does the entity disaggregate revenue recognised from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors?

#### IFRS 15.887

IFRS 15.114 requires an entity to disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Consequently, the extent to which an entity’s revenue is disaggregated for the purposes of this disclosure depends on the facts and circumstances that pertain to the entity’s contracts with customers. Some entities may need to use more than one type of category to meet the objective in IFRS 15.114 for disaggregating revenue. Other entities may meet the objective by using only one type of category to disaggregate revenue.

When selecting the type of category (or categories) to use to disaggregate revenue, an entity must consider how information about the entity’s revenue has been presented for other purposes, including all of the following:

a. Disclosures presented outside the financial statements (for example, in earnings releases, annual reports or investor presentations)

b. Information regularly reviewed by the chief operating decision maker for evaluating the financial performance of operating segments

c. Other information that is similar to the types of information identified in IFRS 15.888(a) and (b) and that is used by the entity or users of the entity’s financial statements to evaluate the entity’s financial performance or make resource allocation decisions

#### IFRS 15.888

Examples of categories that might be appropriate include, but are not limited to, all of the following:

- Type of good or service (for example, major product lines)
- Geographical region (for example, country or region)
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<thead>
<tr>
<th>Disclosure made</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
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</thead>
<tbody>
<tr>
<td><strong>Market or type of customer</strong> (for example, government and non-government customers)</td>
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<tr>
<td><strong>Type of contract</strong> (for example, fixed-price and time-and-materials contracts)</td>
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<td><strong>Contract duration</strong> (for example, short-term and long-term contracts)</td>
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<td><strong>Timing of transfer of goods or services</strong> (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time)</td>
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<tr>
<td><strong>Sales channels</strong> (for example, goods sold directly to consumers and goods sold through intermediaries)</td>
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</table>

**Contract balances**

- If the entity applies IFRS 8 Operating Segments, does the entity disclose sufficient information to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue and revenue information that is disclosed for each reportable segment?

- **Contract liabilities**
  - Does the entity disclose all of the following:
    - The opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed?
    - Revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period?
    - Revenue recognised in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (for example, changes in transaction price)?

**Performance obligations**

- Does the entity disclose information about its performance obligations in contracts with customers, including a description of all of the following:
  - When the entity typically satisfies its performance obligations (for example, upon shipment, upon delivery, as services are rendered or upon completion of service), including when performance obligations are satisfied in a bill-and-hold arrangement?
  - The significant payment terms?

**Transaction price allocated to the remaining performance obligations**

- The aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period?
- An explanation of when the entity expects to recognise as revenue the amount disclosed in accordance with IFRS 15.120(a), which the entity discloses in either of the following ways:
  - On a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations?
  - By using qualitative information?
### Significant judgements in the application of IFRS 15

For performance obligations that the entity satisfies over time, does the entity disclose the timing of satisfaction of performance obligations?

- a. The methods used to recognise revenue (for example, a description of the output methods or input methods used and how those methods are applied)
- b. An explanation of why the methods used provide a faithful depiction of the transfer of goods or services

For performance obligations satisfied at a point in time, does the entity disclose the significant judgements made in evaluating when a customer obtains control of promised goods or services?

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<thead>
<tr>
<th>Disclosure made</th>
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### Determining the transaction price and the amounts allocated to performance obligations

a. Determining the transaction price, which includes, but is not limited to, estimating variable consideration, adjusting the consideration for the effects of the time value of money and measuring non-cash consideration

b. Assessing whether an estimate of variable consideration is constrained

c. Allocating the transaction price, including:
   - Allocating discounts to a specific part of the contract (if applicable)
   - Allocating variable consideration to a specific part of the contract (if applicable)

<table>
<thead>
<tr>
<th>Disclosure made</th>
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</table>

### Assets recognised from the costs to obtain or fulfil a contract with a customer

a. The judgements made in determining the amount of the costs incurred to obtain or fulfil a contract with a customer

b. The method it uses to determine the amortisation for each reporting period

<table>
<thead>
<tr>
<th>Disclosure made</th>
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### Practical expedients

- If the entity elects to use the practical expedient in IFRS 15.63 regarding the existence of a significant financing component, does the entity disclose that fact?
- If the entity elects to use the practical expedient in IFRS 15.94 regarding the incremental costs of obtaining a contract, does the entity disclose that fact?
## Appendix B: Illustrative examples included in the standard

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<tr>
<th>Example</th>
<th>Description</th>
<th>Section</th>
</tr>
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<td>3.1.5</td>
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<td>Reassessing the criteria for identifying a contract</td>
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<td>6</td>
<td>Change in the transaction price after a contract modification</td>
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<td>7</td>
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<td>15</td>
<td>Asset has no alternative use to the entity</td>
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<td>16</td>
<td>Enforceable right to payment for performance completed to date</td>
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<td>Assessing whether a performance obligation is satisfied at a point in time or over time</td>
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<td>21</td>
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<tr>
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<td>Not Included</td>
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<td>Bill-and-hold arrangement</td>
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</table>
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