



**Revenue from Contracts
with Customers**

A guide to IFRS 15

March 2018

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Foreword

The IASB's Standard IFRS 15 *Revenue from Contracts with Customers* is now effective (for periods beginning on or after 1 January 2018 with earlier adoption permitted). It is imperative that entities take time to consider the impact of the new Standard. In some cases, IFRS 15 will require significant changes to systems and may significantly affect other aspects of operations. (e.g. internal controls and processes, KPIs, compensation and bonus plans, bank covenants, tax etc.).

This guide is intended to assist preparers and users of financial statements to understand the impact of IFRS 15. We begin with a high-level executive summary of the new requirements, followed by a specific focus on the important issues and choices available for entities on transition to the new Standard. Our detailed guide covers all of the requirements of IFRS 15, supplemented by interpretations and examples to give clarity to those requirements, and pointers regarding practical issues that are likely to arise.

In the appendices, we provide:

- a. Illustrative disclosures for entities that have adopted IFRS 15; and
- b. a comparison with US Generally Accepted Accounting Principles (US GAAP).

We trust that you will find this guide informative and a useful reference source.

Within the detailed guide, paragraphs that represent the authors' interpretations, material drawn from the IASB's Basis of Conclusions on IFRS 15, and examples other than those cited in IFRSs are highlighted by green shading.

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Executive summary

IFRS 15 is applicable for entities reporting in accordance with International Financial Reporting Standards (IFRSs) for periods beginning on or after 1 January 2018, with earlier application permitted. The new Standard is the result of a joint project by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to develop a converged set of accounting principles to be applied under both IFRSs and US GAAP. It is relevant across all industries and for most types of revenue transaction. IFRS 15 outlines a single comprehensive model of accounting for revenue arising from contracts with customers.

What has changed?

IFRS 15 is a complex Standard, introducing far more prescriptive requirements than were previously included in the IFRSs that it replaces (IAS 18 *Revenue*, IAS 11 *Construction Contracts* and a number of Interpretations related to those Standards) and, therefore, it may result in substantial changes to revenue recognition policies for some entities. It requires the application of significant judgement in some areas, but in other areas it is relatively prescriptive, allowing little room for judgement.

Whereas IAS 18 provides separate revenue recognition criteria for goods and services, this distinction is removed under IFRS 15. The new Standard focuses instead on the identification of performance obligations and distinguishes between performance obligations that are satisfied 'at a point in time' and those that are satisfied 'over time', which is determined by the manner in which control of goods or services passes to the customer. The new revenue model under IFRS 15 means that revenue may be recognised over time for some deliverables accounted for under IAS 18 as goods (e.g. some contract manufacturing); it also means that revenue may be recognised at a point in time for some deliverables accounted for under IAS 18 as services (e.g. some construction contracts).

Specific topics on which more prescriptive requirements have been introduced include:

- the identification of a contract with a customer;
- the identification of distinct performance obligations and the allocation of the transaction price between those obligations;
- accounting for variable consideration and significant financing components;

- recognition of revenue arising from licences; and
- presentation and disclosure of revenue from contracts with customers, and other balances related to revenue.

Other changes include:

- the scope of IFRS 15 has been expanded to cover costs relating to contracts;
- the recognition of interest revenue and dividend revenue are not within the scope of IFRS 15. These matters are now dealt with under IFRS 9 *Financial Instruments* (or, for entities that have not yet adopted IFRS 9, IAS 39 *Financial Instruments: Recognition and Measurement*); and
- specifically excluded from the scope of IFRS 15 are non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. This scope exclusion is different from the related guidance under IAS 18:12 which refers to exchange transactions that are not regarded as transactions that generate revenue – these are transactions in which goods or services are "exchanged or swapped for goods or services which are of a similar nature and value".

At a glance

Current requirements	
Revenue recognition	
IAS 11	Construction contracts
IAS 18	Sales of goods
IAS 18	Sales of services
IFRIC 15	Real estate sales
IAS 18	Royalties
IFRIC 13	Customer loyalty programmes
IFRIC 18	Transfers of assets from customers
SIC 31	Advertising barter transactions
	Previously little guidance on costs of obtaining and fulfilling a contract
Other revenue	
IAS 18	Interest
IAS 18	Dividends

New requirements	
Revenue from contracts with customers	
IFRS 15	Point in time or over time
	New guidance on royalty revenue
	New guidance on options for additional goods and services and breakage
	Guidance on non-cash consideration
	New guidance on costs of obtaining and fulfilling a contract
Other revenue	
IAS 39 or IFRS 9	Interest
	Dividends

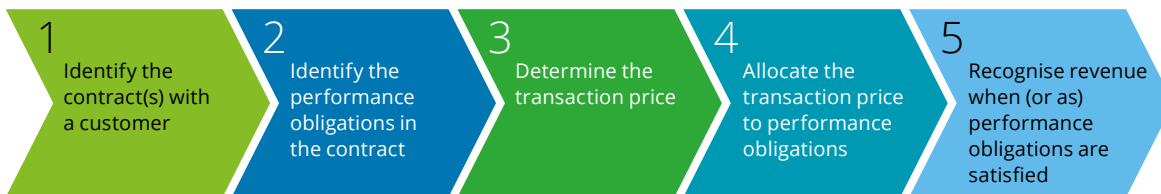
Scope

IFRS 15 applies to all contracts with customers, except for those that are within the scope of other IFRSs. Contracts that are outside the scope of IFRS 15 include leases (IFRS 16 *Leases* or, for entities that have not yet adopted IFRS 16, IAS 17 *Leases*), insurance contracts (IFRS 17 *Insurance Contracts*, or for entities that have not yet adopted IFRS 17, IFRS 4 *Insurance Contracts*), financial instruments (IFRS 9 *Financial Instruments* or, for entities that have not yet adopted IFRS 9, IAS 39 *Financial Instruments: Recognition and Measurement*) and certain non-monetary exchanges. It is possible that a contract with a customer may be partially within the scope of IFRS 15 and partially within the scope of another standard.

Core principle

The core principle underlying the new model is that an entity should recognise revenue in a manner that depicts the pattern of transfer of goods and services to customers. The amount recognised should reflect the amount to which the entity expects to be entitled in exchange for those goods and services. In order to meet the core principle, IFRS 15 adopts a five-step model.

Scope, core principle and key terms



Five-step model

Requirement of the Standard

Detailed discussion

Step 1 requires an entity to identify the contract with the customer. A contract does not have to be written in order for it to meet the criteria for revenue recognition; however, it does need to create enforceable rights and obligations. IFRS 15 provides detailed guidance on how to identify a contract. This step also considers when it is appropriate to combine contracts (see **5.5**) and the implications for revenue recognition of modifying a contract (see **section 10**).

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Step 2 requires an entity to identify the distinct goods or services promised within the contract. Distinct goods and services should be accounted for as separate deliverables (this process is sometimes known as 'unbundling'). These distinct goods and services are referred to as 'performance obligations'. Specific guidance should be considered to determine whether a good or service is distinct.

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Further guidance is also provided in IFRS 15 to identify distinct performance obligations in particular scenarios:

- warranties (see **6.3.4**);
- customer options to purchase additional goods and services at a discount (or for free) (see **6.3.5**); and
- non-refundable upfront fees (see **6.3.6**).

Step 3 requires an entity to determine the transaction price for the contract. This will be affected by a number of factors including:

Section 7

- variable consideration (see **7.2**);
- the extent to which the recognition of variable consideration should be constrained (see **7.2.8**);
- significant financing components within a contract, which will require an adjustment for the time value of money (see **7.4**);
- if non-cash consideration is received in exchange for transferring promised goods or services (see **7.5**); and
- if any consideration is payable to the customer as part of the transaction (see **7.6**).

Step 4 requires an entity to allocate the transaction price determined in Step 3 to the performance obligations identified in Step 2. IFRS 15 requires this allocation to be based on the stand-alone selling price of each performance obligation and includes detailed requirements on how any discounts or variable consideration should be treated in the allocation (see **8.3** and **8.5**, respectively).

Section 8

Further guidance is included within IFRS 15 regarding how entities should account for:

- ‘breakage’ (customers’ unexercised rights) (see **7.7**); and
- changes in the transaction price (see **8.6**).

In principle, allocation on a stand-alone selling price basis requires a calculation to be performed for each contract containing more than one performance obligation. This may prove a significant logistical challenge for entities with a very large number of different contracts, and in some cases changes to existing systems may be needed.

Step 5 specifies how an entity should determine when to recognise revenue in relation to a performance obligation, and whether that revenue should be recognised at a point in time or over a period of time. IFRS 15 focuses on when control of the good or service passes to the customer, which may be over time or at a point in time.

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Other areas of guidance in IFRS 15

In addition to the five-step model, IFRS 15 provides specific guidance relating to licenses and costs relating to a contract.

- In respect of licences, IFRS 15 distinguishes between two different types of licence (right of use and right to access), with the timing of revenue recognition being different for each (see **section 11**).
- IFRS 15 provides guidance on how to account for costs relating to a contract, distinguishing between costs of obtaining a contract and costs of fulfilling a contract. When this results in costs being capitalised, additional guidance is provided on determining an appropriate amortisation period and on impairment considerations (see **section 12**).

Dealing with transition

The transition to IFRS 15 will affect all businesses, to varying degrees and with the transition date fast approaching (periods beginning on or after 1 January 2018), businesses need to consider carefully the new requirements and resolve any potential accounting issues in advance. There are two significant impacts that entities will need to consider when implementing the new Standard, as well as wider business impacts.

The timing of revenue and profit recognition

Whereas previously IFRSs allowed significant room for judgement in devising and applying revenue recognition policies and practices, IFRS 15 is more prescriptive in many areas. Applying these new rules may result in significant changes to the profile of revenue and, in some cases, cost recognition, as well as wider business impacts.

Current accounting processes may require significant changes to cope with the new Standard

As explained throughout this guide, IFRS 15 introduces new requirements to move to a more prescriptive approach based around a five-step model. The complexity of applying this approach and of producing the detailed disclosures required by the new Standard may require modifications to existing accounting processes.

In determining the extent to which modifications will be required, entities may wish to consider the need for sufficient flexibility to cope with future changes in the pricing and variety of product offerings made to customers. The 1 January 2018 effective date now presents a challenging timeframe for developing and implementing new systems.

Wider business impacts

In addition IFRS 15 will have an effect on the wider business. The following list highlights aspects of the business that may be affected by the transition to IFRS 15, although it is not intended to be exhaustive.

- Training for employees – entities should provide training to those employees affected by the changes. These will include accountants, internal auditors and those responsible for drawing up customer contracts.
- Bank covenants – changes in the revenue recognition accounting methods may change the amount, timing and presentation of revenue, with a consequent impact on profits and net assets. This may affect the financial results used in the calculation of an entity's bank covenants. As such, affected entities should seek discussions with lenders, to establish whether renegotiation of covenants will be necessary.
- KPIs – where they are based on a reported revenue or profit figure, they may be impacted by the changes. As such, an entity should evaluate the effect of the Standard on key financial ratios and performance indicators that may be significantly impacted by the changes with a view to determining whether its KPI targets should be adjusted. Where there are changes, an entity will also need to consider how to explain these to investors.
- Compensation and bonus plans – bonuses paid to employees are sometimes dependent on revenue or profit figures achieved. Changes in the recognition of revenue as a result of IFRS 15 may have an impact on the ability of employees to achieve these targets, or on the timing of achievement of these targets and entities may wish to consider whether it is appropriate to change the terms of existing remuneration arrangements where this is the case.
- Ability to pay dividends – in certain jurisdictions, the ability to pay dividends to shareholders is impacted by recognised profits, which in turn are affected by the timing of revenue recognition. Where this is the case, entities will need to determine whether the changes will significantly affect the timing of revenue and profit recognition and, where appropriate, communicate this to stakeholders and update business plans.
- Tax – the profile of tax cash payments, and the recognition of deferred tax, could be impacted due to differences in the timing of recognition of revenue under IFRS 15.
- Stakeholders – users of the financial statements such as the Board of Directors, audit committee, analysts, investors, creditors and shareholders will require an explanation of the changes in IFRS 15 in order to understand how the financial statements have been impacted.

Who to involve

Good project governance will be essential in preparing for the implementation of IFRS 15 and, when appropriate, representatives from the following departments should be involved in discussions and planning:

- accounting/finance;
- operations;
- procurement;
- information technology;
- tax;
- treasury; and
- investor relations.

Once the various stakeholders have been identified, conversations can begin regarding timelines and responsibilities. Support from external providers may also be desirable at some stages during the transition project.

Transition reliefs

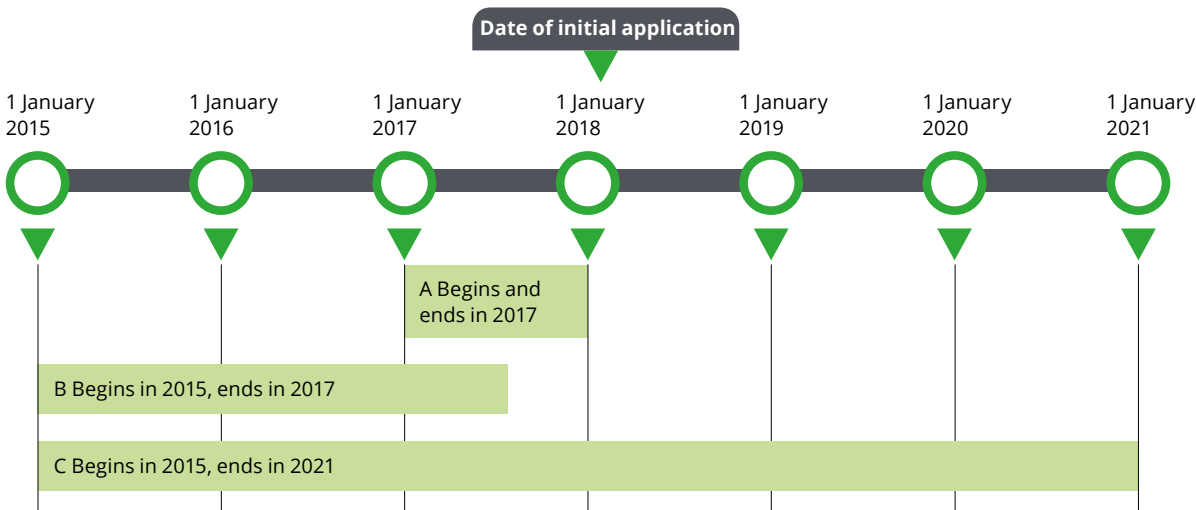
As set out in section 15 of our detailed guide, entities have two options for transitioning to IFRS 15. Both options are fairly detailed but helpful in providing some relief on initial application of IFRS 15. Both of these options make reference to the date of initial application – which is the start of the reporting period in which an entity first applies the Standard. For example, entities applying the Standard for the first time in financial statements for the year ending 31 December 2018 will have a date of initial application of 1 January 2018.

Transition timeline

Example

Assume December 31 Y/E

Assume 1 year of comparatives only



Method 1 Full retrospective approach

- Contract A Begins and ends in same annual reporting period and completed before the date of initial application – Practical expedient available
- Contract B Adjust opening balance of each affected component of equity for the earliest prior period presented (1 January 2017)
- Contract C Adjust opening balance of each affected component of equity for the earliest prior period presented (1 January 2017)

Method 2 Modified approach

- Contract A Contract completed before the date of initial application – Do not apply IFRS 15
- Contract B Contract completed before the date of initial application – Do not apply IFRS 15
- Contract C Adjust opening balance of each affected component of equity at date of initial application. Disclose information per paragraph 134.2

Method 1

Full retrospective approach

Entities can apply the Standard retrospectively to all comparative periods presented. Under this option, prior year comparatives are restated, with a resulting adjustment to the opening balance of equity in the earliest comparative period. Where this option is chosen, the Standard provides a number of optional practical expedients.

These include:

- For completed contracts (i.e. contracts where the entity has transferred all of the goods or services identified under IAS 11, IAS 18 and related interpretations), entities are not required to restate contracts that begin and end within the same annual reporting period. For example, for an entity first applying the Standard for a 31 December 2018 year end, contracts entered into and completed in 2017 will not need to be restated.
- For completed contracts, entities are not required to restate any contract that was completed at the beginning of the earliest period presented. For example, for an entity first applying the Standard for a 31 December 2018 year end and presenting comparative information for the year ended 31 December 2017 only, contracts completed by 31 December 2016 do not need to be evaluated.

- 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. This means, in particular, that if the consideration had ceased to be variable by the time the contract was completed (which is the case for many, but not all, contracts), the transaction price can be based on the amount that was ultimately payable by the customer. For example, for contracts completed prior to 31 December 2017, an entity first applying the Standard for a 31 December 2018 year end may base earlier revenue figures on the consideration (including any variable consideration) that was ultimately payable (or at least the estimate of variable consideration as at the date the contract was completed) rather than estimate variable consideration at earlier dates.
- For all periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue. For example, for an entity first applying the Standard for a 31 December 2018 year end, no disclosures will be required about remaining performance obligations as at 31 December 2017 with respect to contracts not yet completed at that date.
- For contracts that were modified before the beginning of the earliest period presented, an entity is not required to apply the requirements for contract modifications, separately to each earlier modification. Instead, an entity can choose to reflect the aggregate effect of those modifications when: (i) identifying the satisfied and unsatisfied performance obligations; (ii) determining the transaction price; and (iii) allocating the transaction price to the satisfied and unsatisfied performance obligations. For example, for an entity first applying the Standard for a 31 December 2018 year end and presenting comparative information for the year ended 31 December 2017 only, a contract that was modified once or more before 1 January 2017 will, for each of the requirements listed above, be accounted for as though all modifications had been part of the contract as originally agreed. Note that any modifications after 1 January 2017 would need to be accounted for individually.

The practical expedients used should be used consistently for all prior periods presented and disclosure should be given with regards to which expedients have been used. To the extent possible, a qualitative assessment of the estimated effect of applying each of those expedients should be provided.

Method 2

Modified approach

Under the modified approach, entities can apply the Standard only from the date of initial application. If they choose this option, they will need to adjust the opening balance of equity at the date of initial application (i.e. 1 January 2018) but they are not required to adjust prior year comparatives. This means that they do not need to consider contracts that have been completed prior to the date of initial application. Broadly, the figures reported from the date of initial application will be the same as if the Standard had always been applied, but figures for comparative periods will remain on the previous basis. When using this approach, entities can elect to apply IFRS 15 retrospectively only to contracts that are not completed contracts (see above) at the date of initial application.

Additionally, entities applying the modified approach may use the practical expedient in respect of contract modifications that is available for entities applying the full retrospective approach (described above), either for:

- all contract modifications that occur before the beginning of the earliest period presented; or
- all contract modifications that occur before the date of initial application.

If the modified approach is used, disclosure is required of the amount by which each financial statement line item is affected in the current period as a result of applying the new Standard and an explanation of the significant changes between the reported results under IFRS 15 and the previous revenue guidance followed.

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Section 1. Introduction

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Section 1. Introduction

1.1 Development of IFRS 15

In 2002, the IASB and the FASB commenced a joint revenue project with the following key objectives:

- to remove inconsistencies and weaknesses in existing revenue requirements;
- to provide a more robust framework for addressing revenue issues;
- to improve comparability of revenue recognition practices across entities, jurisdictions and capital markets;
- to provide more useful information to users of financial statements through improved disclosure requirements; and
- to simplify the preparation of financial statements by reducing the number of requirements to which preparers must refer (particularly for entities who have previously reported under US GAAP).

The final Standard was issued in May 2014 and supersedes:

- IAS 11 *Construction Contracts*;
- IAS 18 *Revenue*;
- IFRIC 13 *Customer Loyalty Programmes*;
- IFRIC 15 *Agreements for the Construction of Real Estate*;
- IFRIC 18 *Transfers of Assets from Customers*; and
- SIC-31 *Revenue – Barter Transactions Involving Advertising Services*.

The final Standard is nearly fully converged with the US GAAP equivalent; the most significant differences capable of having the biggest impact relate to the collectability threshold for contracts and some differences in the availability of practical expedients. A detailed list of the differences between IFRS 15 and the US GAAP equivalent is provided in Appendix 2.

1.2 Amendments to IFRS 15 – April 2016

IFRS 15 was amended in April 2016 by Clarifications to IFRS 15 *Revenue from Contracts with Customers*.

The amendments were issued in response to feedback received from the IASB/FASB Joint Transition Resource Group for Revenue Recognition (see **1.3**). The amendments added clarifications and additional illustrative examples to IFRS 15 on the following topics:

- identifying performance obligations;
- principal versus agent considerations; and
- licensing.

The amendments also provided two further practical expedients for entities transitioning to IFRS 15.



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The effective date of the April 2016 amendments is the same as for IFRS 15 (i.e. 1 January 2018, with earlier application permitted). The amendments clarify the IASB's intentions when developing the requirements in IFRS 15 but have not changed the underlying principles of the Standard. Entities will generally be expected to implement the amendments in the first accounting period in which they apply IFRS 15, although entities that adopt IFRS 15 for a period beginning before 1 January 2018 may choose not to implement the amendments at the same time. In such circumstances, when the entity does subsequently implement the amendments, the effects of initially applying IFRS 15 should be restated for the effects, if any, of initially applying the amendments.

For the purposes of this guide, it is assumed that the April 2016 amendments are implemented at the same time as IFRS 15 and, consequently, the text reflects the April 2016 amendments.

1.3 Transition Resource Group for Revenue Recognition

Following the publication of IFRS 15, and the equivalent US GAAP standard, the IASB and the FASB formed the IASB/FASB Joint Transition Resource Group for Revenue Recognition (TRG). This group, which comprises both IFRS and US GAAP constituents, is intended to help the boards identify and consider any diversity in practice in applying the standards and to address implementation issues as they arise. The TRG does not issue guidance but discusses issues in public. In circumstances when the TRG concludes that further guidance may be helpful to users of the standards, it refers the issue to the IASB and the FASB for consideration.

In January 2016, the IASB decided not to schedule further meetings of the IFRS constituents of the TRG. However, the TRG has not been disbanded and will be available for consultation by the IASB if needed.

Further information about the TRG and summaries of its discussions can be found at:

<http://www.ifrs.org/groups/transition-resource-group-for-revenue-recognition/#about>

TRG

Throughout the remainder of this practical guide, issues which have been discussed by the TRG are marked by this icon.



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Section 2. Definitions



Section 2. Definitions

Appendix A to IFRS 15 provides the following definitions for terms used in the Standard.

- A **contract** is defined as “[a]n agreement between two or more parties that creates enforceable rights and obligations”.
- A **contract asset** is defined as “[a]n entity’s right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity’s future performance)”.
- A **contract liability** is defined as “[a]n entity’s obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer”.
- A **customer** is defined 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”.
- **Income** is defined as “[i]ncreases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants”.
- A **performance obligation** is defined as “[a] promise in a contract with a customer to transfer to the customer either:
 - a. a good or service (or a bundle of goods or services) that is distinct; or
 - b. a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer”.
- **Revenue** is defined as “[i]ncome arising in the course of an entity’s ordinary activities”.
- The **stand-alone selling price** of a good or service is defined as “[t]he price at which an entity would sell a promised good or service separately to a customer”.
- The **transaction price** for a contract with a customer is defined as “[t]he 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”.



Section 3. General principles and scope

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Section 3. General principles and scope

3.1 Objective of IFRS 15

The objective of IFRS 15 is to establish the principles that should be applied by an entity in order to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. [IFRS 15:1]

3.2 Core principle of IFRS 15

The core principle of IFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers, reflecting the amount of consideration to which the entity expects to be entitled in exchange for those goods or services. [IFRS 15:2]

When applying IFRS 15, it is important to evaluate the terms of the contract and all relevant facts and circumstances. [IFRS 15:3]

3.3 Consistent application of IFRS 15

IFRS 15 should be applied consistently to contracts with similar characteristics and in similar circumstances. This requirement for consistent application is specifically extended to the use of any practical expedients. [IFRS 15:3]

3.4 Practical expedient – application to a portfolio of contracts (or performance obligations)

Although IFRS 15 specifies the accounting for an individual contract with a customer, the Standard allows as a practical expedient that it can be applied to a portfolio of contracts (or performance obligations) with similar characteristics provided that it is reasonably expected that the effects on the financial statements of applying a portfolio approach will not differ materially from applying IFRS 15 to the individual contracts (or performance obligations) within that portfolio. When accounting for a portfolio, estimates and assumptions that reflect the size and composition of the portfolio should be used. [IFRS 15:4]

Some entities manage a very large number of customer contracts and offer a wide array of product combination options (e.g. entities in the telecommunications industry may offer a wide selection of handsets and wireless usage plan options). For these entities, it would take significant effort to apply some of the requirements of IFRS 15 (e.g. the requirement to allocate based on the stand-alone selling price to the identified performance obligations as described in **section 8**) on an individual contract basis. In addition, the capability of information technology systems to capture the relevant information may be limited.

Entities will need to evaluate whether they are eligible to use a portfolio approach under IFRS 15:4. IFRS 15 does not provide explicit guidance on how to (1) evaluate 'similar characteristics', and (2) establish a reasonable expectation that the effects of applying a portfolio approach would not differ materially from those of applying the Standard at a contract or performance obligation level. Accordingly, entities will need to exercise significant judgement in determining that the contracts or performance obligations that they have segregated into portfolios have similar characteristics at a sufficiently granular level to ensure that the outcome of using a particular portfolio approach can reasonably be expected not to differ materially from the results of applying the Standard to each contract or performance obligation in the portfolio individually.



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In segregating contracts (or performance obligations) with similar characteristics into portfolios, entities should apply objective criteria associated with the particular contracts or performance obligations and their accounting consequences. When determining whether particular contracts have similar characteristics, entities may find it helpful to focus particularly on those characteristics that have the most significant accounting consequences under IFRS 15 in terms of their effect on the timing of revenue recognition or the amount of revenue recognised. Accordingly, the assessment of which characteristics are most important for determining similarity will depend on an entity's specific circumstances. However, there may also be practical constraints on the entity's ability to use existing systems to analyse a portfolio of contracts, and these constraints could affect its determination of how the portfolio should be segregated.

The table below lists objective criteria that entities might consider when assessing whether particular contracts or performance obligations have similar characteristics in accordance with IFRS 15:4. Because any of the requirements in IFRS 15 could have significant consequences for a particular portfolio of contracts, the list provided is not exhaustive.

Objective criteria	Example
Contract deliverables	Mix of products and services, options to acquire additional goods and services, warranties, promotional programmes
Contract duration	Short-term, long-term, committed or expected term of contract
Terms and conditions of the contract	Rights of return, shipping terms, bill and hold, consignment, cancellation privileges and other similar clauses
Amount, form and timing of consideration	Fixed, time and material, variable, upfront fees, non-cash, significant financing component
Characteristics of the customers	Size, type, creditworthiness, geographical location, sales channel
Characteristics of the entity	Volume of contracts that include the different characteristics, historical information available
Timing of transfer of goods or services	Over time or at a point in time

Example 3.4A

Application of the portfolio approach

Entity A offers various combinations of handsets and usage plans to its customers under two-year contracts. It offers two handset models: an older model that it offers free of charge (stand-alone selling price is CU250); and the most recent model, which offers additional features and functionalities and for which the entity charges CU200 (stand-alone selling price is CU500). The entity also offers two usage plans: a 400-minute plan and an 800-minute plan. The 400-minute plan sells for CU40 per month, and the 800-minute plan sells for CU60 per month (which also corresponds to the stand-alone selling price for each plan).

The table below illustrates the possible product combinations and the allocation of consideration for each under IFRS 15.



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	Product combination	Total transaction price	Revenue on handset		Revenue on usage	
			CU*	% of total contract revenue	CU	% of total contract revenue
Customer A	Old handset, 400 minutes	960	198	21	762	79
Customer B	Old handset, 800 minutes	1,440	213	15	1,227	85
Customer C	New handset, 400 minutes	1,160	397	34	763	66
Customer D	New handset, 800 minutes	1,640	423	26	1,217	74

In this example, the proportion of the total transaction price allocated to handset revenue is determined by comparing the stand-alone selling price for the phone to the total of the stand-alone selling prices of the components of the contract.

Customer A: $(\text{CU}250/(\text{CU}250+\text{CU}960) \times \text{CU}960) = \text{CU}198$

Customer B: $(\text{CU}250/(\text{CU}250+\text{CU}1,440) \times \text{CU}1,440) = \text{CU}213$

Customer C: $(\text{CU}500/(\text{CU}500+\text{CU}960) \times \text{CU}1,160) = \text{CU}397$

Customer D: $(\text{CU}500/(\text{CU}500+\text{CU}1,440) \times \text{CU}1,640) = \text{CU}423$

As the table indicates, the effects of each product combination on the financial statements differ from those of the other product combinations. The four customer contracts have different characteristics, and it may be difficult to demonstrate that Entity A 'reasonably expects' that the financial statement effects of applying the guidance to the portfolio (the four contracts together) 'would not differ materially' from those of applying the guidance to each individual contract. The percentage of contract consideration allocated to the handset under the various product combinations ranges from 15 per cent to 34 per cent. Entity A may consider that this range is too wide to apply a portfolio approach; if so, some level of segregation would be required. Alternatively, Entity A might determine that there are two portfolios – one for old handsets and the other for new handsets. Under this alternative approach, Entity A would need to perform additional analysis to assess whether the accounting consequences of using two rather than four portfolios would result in financial statement effects that differ materially.

The circumstances described in **example 3.4A** are relatively straightforward. In practice, however, the contracts illustrated could involve additional layers of complexity, such as (1) different contract durations; (2) different call and text messaging plans; (3) different pricing schemes (e.g. fixed or variable pricing based on usage); (4) different promotional programmes, options, and incentives; and (5) contract modifications. Accounting for such contracts could be further complicated by the rapid pace of change in product offerings.



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In general, the more specific the criteria an entity uses to segregate its contracts or performance obligations into portfolios (i.e. the 'greater' the extent of disaggregation), the easier it should be for the entity to conclude that the results of applying the guidance to a particular portfolio are not expected to differ materially from the results of applying the guidance to each individual contract (or performance obligation) in the portfolio. However, further disaggregation into separate sub-portfolios is likely to improve the overall accuracy of estimates only if those sub-portfolios have some characteristics that are different. For example, segregating on the basis of geographical location may not be beneficial if similar combinations of products and services that have similar terms and conditions are sold to a similar group of customers in different geographical areas. Likewise, segregating on the basis of whether contract terms allow a right of return may not be necessary if the returns are not expected to be significant.

While there is no requirement in IFRS 15 to quantitatively evaluate whether using a portfolio approach would produce an outcome materially different from that of applying the guidance at the contract or performance obligation level, an entity should be able to demonstrate why it reasonably expects the two outcomes not to differ materially. The entity may do so by various means depending on its specific circumstances (subject to the constraints of a cost-benefit analysis).

Such means include, but are not limited to, the following:

- data analytics based on reliable assumptions and underlying data (internally- or externally-generated) related to the portfolio;
- a sensitivity analysis that evaluates the characteristics of the contracts or performance obligations in the portfolio and the assumptions used to determine a range of potential differences in applying the different approaches; and
- a limited quantitative analysis, supplemented by a more extensive qualitative assessment that may be performed when the portfolios are disaggregated.

Typically, some level of objective and verifiable information would be necessary to demonstrate that using a portfolio approach would not result in a materially different outcome. An entity may also wish to (1) consider whether the costs of performing this type of analysis potentially outweigh the benefits of accounting on a portfolio basis, and (2) assess whether it is preferable to invest in systems solutions that would allow accounting on an individual contract basis.

Example 3.4B

Application of a portfolio approach to part of a customer base

Entity A is a telecommunications company that has a large number of contracts with customers with similar characteristics. Entity A does not elect to use a portfolio approach as specified in IFRS 15:4 when accounting for revenue from those contracts; instead, it has developed specialised computer systems that enable it to recognise revenue on a contract-by-contract basis.

At a later date, Entity A acquires Entity B, which operates in the same jurisdiction as Entity A and also has a large number of contracts with customers with characteristics that are similar to those of Entity A. Entity B, which does not have computer systems that would enable it to recognise revenue on a contract-by-contract basis, has previously elected to use a portfolio approach under IFRS 15:4 when accounting for revenue from those contracts.



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In its consolidated financial statements, is Entity A permitted to use a portfolio approach only for contracts with Entity B's customers?

Yes. Entity A is permitted to use a portfolio approach to account for Entity B's contracts with customers provided that Entity A reasonably expects that the effects of using that approach would not differ materially from applying IFRS 15 on a contract-by-contract basis.

The requirement in IFRS 15:3 to apply IFRS 15 consistently, including the use of any practical expedients, to contracts with similar characteristics and in similar circumstances does not override the overall concept of materiality. The practical expedient in IFRS 15:4 is only available if it is reasonably expected that the financial statement effects of applying a portfolio approach would not differ materially from the effects of applying IFRS 15 to the individual contracts within that portfolio. Accordingly, it is possible for entities to prepare consolidated financial statements using a mixture of approaches because the resulting accounting effects are not reasonably expected to differ materially.

3.5 Scope of IFRS 15

3.5.1 Scope – general

IFRS 15 should be applied to all contracts with customers, except the following:

[IFRS 15:5]

- lease contracts within the scope of IFRS 16 *Leases* or, for entities that have not yet adopted IFRS 16, IAS 17 *Leases*;
- for entities that have adopted IFRS 17 *Insurance Contracts* (effective for annual periods beginning on or after 1 January 2021, with earlier application permitted), contracts within the scope of that Standard. However, an entity may choose to apply IFRS 15 to insurance contracts that have as their primary purpose the provision of services for a fixed fee in accordance with IFRS 17:8;
- for entities that have not yet adopted IFRS 17, 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, for entities that have not yet adopted IFRS 9, 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*; and
- non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, IFRS 15 would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

Note that the wording in the last bullet point above is different from the equivalent requirement in IAS 18. IAS 18 instead refers to goods or services that are “exchanged or swapped for goods or services which are of a similar nature and value”. [IAS 18:12]

Entities are not permitted to recognise revenue resulting from a non-monetary transaction that is subject to the scope exception in the last bullet point above. As explained in IFRS 15:BC58 and BC59, the party exchanging inventory with the entity in a transaction of this nature meets the definition of a customer and, in the absence of this specific scope exclusion, the entity might recognise revenue once for the exchange of inventory and do so again for the sale of inventory to the end customer. The IASB concluded that this outcome would be inappropriate because (1) it would gross up revenues and expenses and thereby make it difficult for the users of financial statements to assess the entity's performance and gross margins, and (2) the counterparty in such an exchange transaction could be viewed as acting as a supplier rather than as a customer.



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Example 3.5.1

Accounting for the lapse of warrants

An entity has issued warrants (options issued on the entity's own shares) for cash. These warrants meet the definition of equity instruments under IAS 32 *Financial Instruments: Presentation* and, accordingly, the amount received for issuing them was credited to equity. The warrants lapse unexercised.

No revenue should be recognised when the warrants lapse unexercised. The definition of income (which encompasses both revenue and gains in accordance with the *Conceptual Framework for Financial Reporting*) excludes contributions from equity participants. The issuance of the warrants is a transaction with owners (equity participants). The fact that an equity participant no longer has an equity claim on the assets of the entity does not convert the equity contribution into income. Amounts for warrants classified as equity instruments may be transferred to another account within equity (e.g. contributed surplus) as of the date the warrants expire.

3.5.2 Scope limited to contracts with 'customers'

IFRS 15 applies to a contract (other than a contract listed in IFRS 15:5) only if the counterparty to the contract is a customer; a customer is defined 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". [IFRS 15:6 & Appendix A]

As an example of a counterparty to a contract that is not a customer, the Standard cites a counterparty that has contracted with the entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as developing an asset in a collaborative arrangement) rather than to obtain the output of the entity's ordinary activities. [IFRS 15:6]

3.5.3 Contracts partially within the scope of IFRS 15

A contract with a customer may be partially within the scope of IFRS 15 and partially within the scope of the other Standards listed at 3.5.1.

[IFRS 15:7]

- (a) If the other Standards specify how to separate and/or initially measure one or more parts of the contract, then an entity first applies the separation and/or measurement requirements of those Standards. The amounts of the parts of the contract that are initially measured in accordance with other Standards are excluded from the transaction price. The requirements of IFRS 15:73 to 86 (see **section 8**) are then applied to allocate the amount of the transaction price that remains (if any) to each performance obligation within the scope of IFRS 15 and to any other parts of the contract identified by IFRS 15:7(b).
- (b) If the other Standards do not specify how to separate and/or initially measure one or more parts of the contract, then IFRS 15 is applied to separate and/or initially measure the part (or parts) of the contract.

3.5.4 Scope – contract costs

IFRS 15 specifies the accounting for the incremental costs of obtaining a contract with a customer and for the costs incurred to fulfil a contract with a customer if those costs are not within the scope of another Standard (see **section 12**). These requirements only apply to the costs incurred that relate to a contract with a customer (or part of that contract) that is within the scope of IFRS 15. [IFRS 15:8]



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3.6 Principal versus agent considerations

3.6.1 Determining the nature of the entity's promise

When another party is involved in providing goods or services to a customer, the entity should determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (i.e. it is acting as a principal) or to arrange for those goods or services to be provided by the other party (i.e. it is acting as an agent). An entity should determine whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) provided to the customer (see **6.3**). If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others. [IFRS 15:B34]

Assessing whether an entity is acting as a principal or as an agent requires judgement in some circumstances, and different conclusions can significantly affect the amount and timing of revenue recognised.

An entity should determine the nature of its promise for the purposes of applying IFRS 15:B34 by:

[IFRS 15:B34A]

- identifying the specified goods or services to be provided to the customer (which, for example, could be a right to a good or service to be provided by another party (see **6.3.1**)); and
- assessing whether it controls (see **9.1.2**) each specified good or service before that good or service is transferred to the customer.

3.6.2 Entity as a principal

An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer. However, if the entity obtains legal title to a specified good only momentarily before legal title is transferred to a customer, that does not necessarily mean the entity had control of that specified good.

[IFRS 15:B35]

A principal may satisfy its performance obligation to provide the specified good or service itself or it may engage another party (e.g. a subcontractor) to satisfy some or all of the performance obligation on its behalf. [IFRS 15:B35]

When another party is involved in providing goods or services to a customer, a principal obtains control of any one of the following:

[IFRS 15:B35A]

- (a) a good or another asset from the other party that it then transfers to a customer;
- (b) a right to a service to be performed by the other party, which gives the principal the ability to direct that party to provide the service to the customer on its behalf; or
- (c) a good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer. For example, if an entity provides a significant service of integrating goods or services (see IFRS 15:29(a) – **6.3.1**) provided by another party into the specified good or service for which the customer has contracted, the entity controls the specified good or service before that good or service is transferred to the customer. This is because the entity first obtains control of the inputs to the specified good or service, including goods or services from other parties, and directs their use to create the combined output that is the specified good or service.



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Indicators that an entity controls the specified good or service before it is transferred to the customer (and is, therefore, a principal) include the following (the list is not exhaustive):

[IFRS 15:B37]

- (a) the entity is primarily responsible for fulfilling the promise to provide the specified good or service. This will typically include having responsibility for the acceptability of the specified good or service (e.g. primary responsibility for the good or service meeting the customer's specifications). If the entity is primarily responsible for fulfilling the promise to provide the specified good or service, this may indicate that the other party involved in providing the specified good or service is acting on the entity's behalf;
- (b) the entity has inventory risk before the specified good or service is transferred to a customer, or after transfer of control to the customer (e.g. if the customer has a right of return). For example, if the entity obtains, or commits itself to obtain, the specified good or service before obtaining a contract with a customer, this may indicate that the entity has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service before it is transferred to the customer; and
- (c) the entity has discretion in establishing the price for the specified good or service. Establishing the price that the customer pays for the specified good or service may indicate that the entity has the ability to direct the use of that good or service and obtain substantially all of the remaining benefits. However, in certain circumstances an agent may have discretion in establishing prices. For example, an agent may have some flexibility in setting prices in order to generate additional revenue from its own service of arranging for goods or services to be provided by other parties to customers.

The indicators set out in IFRS 15:B37 may be more or less relevant to the assessment of control depending on the nature of the specified good or service and the terms and conditions of the contract. In addition, different indicators may provide more persuasive evidence in different contracts. [IFRS 15:B37A]

The indicators are included in IFRS 15 to support an entity's assessment as to whether it controls a specified good or service before it is transferred to a customer in scenarios where this assessment is difficult. The indicators do not override the application of the general control principle in IFRS 15 and should not be viewed in isolation.

If an entity is no longer acting as a principal, because another entity has assumed the performance obligations and contractual rights in a contract so that the entity is no longer obliged to satisfy the performance obligation, the entity should not recognise revenue for that performance obligation. Instead, the entity should evaluate whether it is now acting as an agent. [IFRS 15:B38]

When (or as) a principal satisfies a performance obligation, it recognises revenue in the gross amount of consideration to which it expects to be entitled in exchange for the specified goods or services transferred. [IFRS 15:B35B]

When, having considered the requirements of IFRS 15:B34 to B38, an entity determines that it acts as a principal in the sale of goods or services, or both, it should recognise revenue for the gross amount to which it is entitled. This is the case even when the entity sells some goods or services to third parties at an amount equal to the cost of the goods or services. The practice of selling goods or providing services at an amount equal to cost does not mean that the proceeds should be presented as a cost reimbursement; revenue and expenses should be presented gross.



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3.6.3 Entity as an agent

An entity is an agent if its performance obligation is to arrange for the provision of the specified good or service by another party. An agent does not control the specified good or service provided by another party before that good or service is transferred to the customer. When (or as) an agent satisfies a performance obligation, the entity recognises revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified goods or services to be provided by the other party. An agent's fee or commission might be the net amount of consideration that it retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party. [IFRS 15:B36]

3.6.4 Recognition of revenue as principal or agent – examples accompanying IFRS 15

Example 3.6.4A

Arranging for the provision of goods or services (entity is an agent) [website operation]

[IFRS 15:IE231 – IE233, Example 45]

An entity operates a website that enables customers to purchase goods from a range of suppliers who deliver the goods directly to the customers. Under the terms of the entity's contracts with suppliers, when a good is purchased via the website, the entity is entitled to a commission that is equal to 10 per cent of the sales price. The entity's website facilitates payment between the supplier and the customer at prices that are set by the supplier. The entity requires payment from customers before orders are processed and all orders are non-refundable. The entity has no further obligations to the customer after arranging for the products to be provided to the customer.

To determine whether the entity's performance obligation is to provide the specified goods itself (ie the entity is a principal) or to arrange for those goods to be provided by the supplier (ie the entity is an agent), the entity identifies the specified good or service to be provided to the customer and assesses whether it controls that good or service before the good or service is transferred to the customer.

The website operated by the entity is the marketplace in which suppliers offer their goods and customers purchase the goods that are offered by the suppliers. Accordingly, the entity observes that the specified goods to be provided to customers that use the website are the goods provided by the suppliers, and no other goods or services are promised to customers by the entity.

The entity concludes that it does not control the specified goods before they are transferred to customers that order goods using the website. The entity does not at any time have the ability to direct the use of the goods transferred to customers. For example, it cannot direct the goods to parties other than the customer or prevent the supplier from transferring those goods to the customer. The entity does not control the suppliers' inventory of goods used to fulfil the orders placed by customers using the website.

As part of reaching that conclusion, the entity considers the following indicators in [IFRS 15:B37 – see 3.6.2]. The entity concludes that these indicators provide further evidence that it does not control the specified goods before they are transferred to the customers:

- (a) the supplier is primarily responsible for fulfilling the promise to provide the goods to the customer. The entity is neither obliged to provide the goods if the supplier fails to transfer the goods to the customer, nor responsible for the acceptability of the goods.
- (b) the entity does not take inventory risk at any time before or after the goods are transferred to the customer. The entity does not commit itself to obtain the goods from the supplier before the goods are purchased by the customer, and does not accept responsibility for any damaged or returned goods.
- (c) the entity does not have discretion in establishing prices for the supplier's goods. The sales price is set by the supplier.

Consequently, the entity concludes that it is an agent and its performance obligation is to arrange for the provision of goods by the supplier. When the entity satisfies its promise to arrange for the goods to be provided by the supplier to the customer (which, in this example, is when goods are purchased by the customer), the entity recognises revenue in the amount of the commission to which it is entitled.



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In **example 3.6.4A**, an important feature of the fact pattern is that the entity has no further obligations to the customer after arranging for the products to be provided to the customer. If this were not the case (e.g. because the entity would be responsible to the customer if the products were faulty), then the analysis could be different.

Example 3.6.4B

Promise to provide goods or services (entity is a principal) [equipment with unique specifications]

[IFRS 15:IE234 – IE238, Example 46]

An entity enters into a contract with a customer for equipment with unique specifications. The entity and the customer develop the specifications for the equipment, which the entity communicates to a supplier that the entity contracts with to manufacture the equipment. The entity also arranges to have the supplier deliver the equipment directly to the customer. Upon delivery of the equipment to the customer, the terms of the contract require the entity to pay the supplier the price agreed to by the entity and the supplier for manufacturing the equipment.

The entity and the customer negotiate the selling price and the entity invoices the customer for the agreed-upon price with 30-day payment terms. The entity's profit is based on the difference between the sales price negotiated with the customer and the price charged by the supplier.

The contract between the entity and the customer requires the customer to seek remedies for defects in the equipment from the supplier under the supplier's warranty. However, the entity is responsible for any corrections to the equipment required resulting from errors in specifications.

To determine whether the entity's performance obligation is to provide the specified goods or services itself (ie the entity is a principal) or to arrange for those goods or services to be provided by another party (ie the entity is an agent), the entity identifies the specified good or service to be provided to the customer and assesses whether it controls that good or service before the good or service is transferred to the customer.

The entity concludes that it has promised to provide the customer with specialised equipment designed by the entity. Although the entity has subcontracted the manufacturing of the equipment to the supplier, the entity concludes that the design and manufacturing of the equipment are not distinct, because they are not separately identifiable (ie there is a single performance obligation). The entity is responsible for the overall management of the contract (for example, by ensuring that the manufacturing service conforms to the specifications) and, thus, provides a significant service of integrating those items into the combined output – the specialised equipment – for which the customer has contracted. In addition, those activities are highly interrelated. If necessary modifications to the specifications are identified as the equipment is manufactured, the entity is responsible for developing and communicating revisions to the supplier and for ensuring that any associated rework required conforms with the revised specifications. Accordingly, the entity identifies the specified good to be provided to the customer as the specialised equipment.

The entity concludes that it controls the specialised equipment before that equipment is transferred to the customer ([IFRS 15:B35A(c) – see 3.6.2]). The entity provides the significant integration service necessary to produce the specialised equipment and, therefore, controls the specialised equipment before it is transferred to the customer. The entity directs the use of the supplier's manufacturing service as an input in creating the combined output that is the specialised equipment. In reaching the conclusion that it controls the specialised equipment before that equipment is transferred to the customer, the entity also observes that, even though the supplier delivers the specialised equipment to the customer, the supplier has no ability to direct its use (ie the terms of the contract between the entity and the supplier preclude the supplier from using the specialised equipment for another purpose or directing that equipment to another customer). The entity also obtains the remaining benefits from the specialised equipment by being entitled to the consideration in the contract from the customer.



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Thus, the entity concludes that it is a principal in the transaction. The entity does not consider the indicators in [IFRS 15:B37 – see **3.6.2**] because the evaluation above is conclusive without consideration of the indicators. The entity recognises revenue in the gross amount of consideration to which it is entitled from the customer in exchange for the specialised equipment.

Example 3.6.4C

Promise to provide goods or services (entity is a principal) [maintenance services]

[IFRS 15:IE238A – IE238G, Example 46A]

An entity enters into a contract with a customer to provide office maintenance services. The entity and the customer define and agree on the scope of the services and negotiate the price. The entity is responsible for ensuring that the services are performed in accordance with the terms and conditions in the contract. The entity invoices the customer for the agreed-upon price on a monthly basis with 10-day payment terms.

The entity regularly engages third-party service providers to provide office maintenance services to its customers. When the entity obtains a contract from a customer, the entity enters into a contract with one of those service providers, directing the service provider to perform office maintenance services for the customer. The payment terms in the contracts with the service providers are generally aligned with the payment terms in the entity's contracts with customers. However, the entity is obliged to pay the service provider even if the customer fails to pay.

To determine whether the entity is a principal or an agent, the entity identifies the specified good or service to be provided to the customer and assesses whether it controls that good or service before the good or service is transferred to the customer.

The entity observes that the specified services to be provided to the customer are the office maintenance services for which the customer contracted, and that no other goods or services are promised to the customer. While the entity obtains a right to office maintenance services from the service provider after entering into the contract with the customer, that right is not transferred to the customer. That is, the entity retains the ability to direct the use of, and obtain substantially all the remaining benefits from, that right. For example, the entity can decide whether to direct the service provider to provide the office maintenance services for that customer, or for another customer, or at its own facilities. The customer does not have a right to direct the service provider to perform services that the entity has not agreed to provide. Therefore, the right to office maintenance services obtained by the entity from the service provider is not the specified good or service in its contract with the customer.

The entity concludes that it controls the specified services before they are provided to the customer. The entity obtains control of a right to office maintenance services after entering into the contract with the customer but before those services are provided to the customer. The terms of the entity's contract with the service provider give the entity the ability to direct the service provider to provide the specified services on the entity's behalf ([IFRS 15:B35A(b) – see **3.6.2**]). In addition, the entity concludes that the following indicators in [IFRS 15:B37 – see **3.6.2**] provide further evidence that the entity controls the office maintenance services before they are provided to the customer:



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- (a) the entity is primarily responsible for fulfilling the promise to provide office maintenance services. Although the entity has hired a service provider to perform the services promised to the customer, it is the entity itself that is responsible for ensuring that the services are performed and are acceptable to the customer (ie the entity is responsible for fulfilment of the promise in the contract, regardless of whether the entity performs the services itself or engages a third-party service provider to perform the services).
- (b) the entity has discretion in setting the price for the services to the customer.

The entity observes that it does not commit itself to obtain the services from the service provider before obtaining the contract with the customer. Thus, the entity has mitigated inventory risk with respect to the office maintenance services. Nonetheless, the entity concludes that it controls the office maintenance services before they are provided to the customer on the basis of the evidence [in the paragraph above].

Thus, the entity is a principal in the transaction and recognises revenue in the amount of consideration to which it is entitled from the customer in exchange for the office maintenance services.

Example 3.6.4D

Promise to provide goods or services (entity is a principal) [airlines]

[IFRS 15:IE239 – IE243, Example 47]

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

The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are purchased.

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

To determine whether the entity's performance obligation is to provide the specified goods or services itself (ie the entity is a principal) or to arrange for those goods or services to be provided by another party (ie the entity is an agent), the entity identifies the specified good or service to be provided to the customer and assesses whether it controls that good or service before the good or service is transferred to the customer.

The entity concludes that, with each ticket that it commits itself to purchase from the airline, it obtains control of a right to fly on a specified flight (in the form of a ticket) that the entity then transfers to one of its customers ([IFRS 15:B35A(a) – see 3.6.2]). Consequently, the entity determines that the specified good or service to be provided to its customer is that right (to a seat on a specific flight) that the entity controls. The entity observes that no other goods or services are promised to the customer.

The entity controls the right to each flight before it transfers that specified right to one of its customers because the entity has the ability to direct the use of that right by deciding whether to use the ticket to fulfil a contract with a customer and, if so, which contract it will fulfil. The entity also has the ability to obtain the remaining benefits from that right by either reselling the ticket and obtaining all of the proceeds from the sale or, alternatively, using the ticket itself.



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The indicators in paragraphs [IFRS 15:B37(b) to (c) – see **3.6.2**] also provide relevant evidence that the entity controls each specified right (ticket) before it is transferred to the customer. The entity has inventory risk with respect to the ticket because the entity committed itself to obtain the ticket from the airline before obtaining a contract with a customer to purchase the ticket. This is because the entity is obliged to pay the airline for that right regardless of whether it is able to obtain a customer to resell the ticket to or whether it can obtain a favourable price for the ticket. The entity also establishes the price that the customer will pay for the specified ticket.

Thus, the entity concludes that it is a principal in the transactions with customers. The entity recognises revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred to the customers.

Example 3.6.4E

Arranging for the provision of goods or services (entity is an agent) [restaurant vouchers]

[IFRS 15:IE244 – IE248, Example 48]

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

The entity and the restaurants jointly determine the prices at which the vouchers will be sold to customers. Under the terms of its contracts with the restaurants, the entity is entitled to 30 per cent of the voucher price when it sells the voucher.

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

To determine whether the entity is a principal or an agent, the entity identifies the specified good or service to be provided to the customer and assesses whether it controls the specified good or service before that good or service is transferred to the customer.

A customer obtains a voucher for the restaurant that it selects. The entity does not engage the restaurants to provide meals to customers on the entity's behalf as described in the indicator in [IFRS 15:B37(a) – see **3.6.2**]. Therefore, the entity observes that the specified good or service to be provided to the customer is the right to a meal (in the form of a voucher) at a specified restaurant or restaurants, which the customer purchases and then can use itself or transfer to another person. The entity also observes that no other goods or services (other than the vouchers) are promised to the customers.



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The entity concludes that it does not control the voucher (right to a meal) at any time. In reaching this conclusion, the entity principally considers the following:

- (a) the vouchers are created only at the time that they are transferred to the customers and, thus, do not exist before that transfer. Therefore, the entity does not at any time have the ability to direct the use of the vouchers, or obtain substantially all of the remaining benefits from the vouchers, before they are transferred to customers.
- (b) the entity neither purchases, nor commits itself to purchase, vouchers before they are sold to customers. The entity also has no responsibility to accept any returned vouchers. Therefore, the entity does not have inventory risk with respect to the vouchers as described in the indicator in [IFRS 15:B37(b) – see 3.6.2].

Thus, the entity concludes that it is an agent with respect to the vouchers. The entity recognises revenue in the net amount of consideration to which the entity will be entitled in exchange for arranging for the restaurants to provide vouchers to customers for the restaurants' meals, which is the 30 per cent commission it is entitled to upon the sale of each voucher.

Example 3.6.4F

Entity is a principal and an agent in the same contract

[IFRS 15:IE248A – IE248F, Example 48A]

An entity sells services to assist its customers in more effectively targeting potential recruits for open job positions. The entity performs several services itself, such as interviewing candidates and performing background checks. As part of the contract with a customer, the customer agrees to obtain a licence to access a third party's database of information on potential recruits. The entity arranges for this licence with the third party, but the customer contracts directly with the database provider for the licence. The entity collects payment on behalf of the third-party database provider as part of the entity's overall invoicing to the customer. The database provider sets the price charged to the customer for the licence, and is responsible for providing technical support and credits to which the customer may be entitled for service down time or other technical issues.

To determine whether the entity is a principal or an agent, the entity identifies the specified goods or services to be provided to the customer, and assesses whether it controls those goods or services before they are transferred to the customer.

For the purpose of this example, it is assumed that the entity concludes that its recruitment services and the database access licence are each distinct on the basis of its assessment of the requirements in [IFRS 15:27 to 30 – see 6.3]. Accordingly, there are two specified goods or services to be provided to the customer – access to the third party's database and recruitment services.

The entity concludes that it does not control the access to the database before it is provided to the customer. The entity does not at any time have the ability to direct the use of the licence because the customer contracts for the licence directly with the database provider. The entity does not control access to the provider's database – it cannot, for example, grant access to the database to a party other than the customer, or prevent the database provider from providing access to the customer.



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As part of reaching that conclusion, the entity also considers the indicators in [IFRS 15:B37 – see **3.6.2**]. The entity concludes that these indicators provide further evidence that it does not control access to the database before that access is provided to the customer:

- (a) the entity is not responsible for fulfilling the promise to provide the database access service. The customer contracts for the licence directly with the third-party database provider and the database provider is responsible for the acceptability of the database access (for example, by providing technical support or service credits).
- (b) the entity does not have inventory risk because it does not purchase, or commit itself to purchase, the database access before the customer contracts for database access directly with the database provider.
- (c) the entity does not have discretion in setting the price for the database access with the customer because the database provider sets that price.

Thus, the entity concludes that it is an agent in relation to the third party's database service. In contrast, the entity concludes that it is the principal in relation to the recruitment services because the entity performs those services itself and no other party is involved in providing those services to the customer.

3.6.5 Recognition of revenue as principal or agent – additional examples

3.6.5.1 Royalty payments

Example 3.6.5.1 **Royalty payments**

Entity A has agreed to pay a royalty to Entity B for the use of intellectual property rights that Entity A requires to make sales to its customers. The royalty is specified as a percentage of gross proceeds from Entity A's sales to its customers less contractually defined costs. Entity A is the principal in the sales transactions with its customers (i.e. it must provide the goods and services itself and does not act as an agent for Entity B).

In Entity A's financial statements, should the royalty payments be netted against revenue or recognised as a cost of fulfilling the contract?

Because Entity A is the principal in respect of the sales to its customers, it should recognise its revenue on a gross basis and the royalty as a cost of fulfilling the contract. Guidance on the appropriate accounting for the costs of fulfilling a contract, including whether such costs should be capitalised or expensed, is provided in IFRS 15:95 to 104 (see **section 12**).



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3.6.5.2 Offsetting revenue and expenses for shared commissions

Example 3.6.5.2

Offsetting revenue and expenses for shared commissions

Company A has signed a contract with an insurance company under which it receives a commission for every policy it sells on behalf of the insurance company. Company A contracts with individual financial advisers to sell these insurance policies and agrees to split the commission evenly with the financial advisers. Company A provides administrative facilities and office space to the financial advisers. The insurance company is aware of the arrangements between Company A and the financial advisers, but its contractual relationship is with Company A and Company A is responsible for providing the service to the insurance company. The insurance company pays the full commission to Company A, which then pays half of the commission to the financial adviser who sold the policy.

Company A has determined that it is acting as a principal in this arrangement, in accordance with IFRS 15:B34 to B38.

Is Company A permitted to offset the amount it pays to the financial advisers against the commission revenue it receives from the insurance company?

No. Company A is acting as a principal in providing services to the insurance company and not as an agent for the financial advisers. Accordingly, it is required to present the revenue it receives for those services as a gross amount.

3.6.5.3 Income tax withheld in a different country

Example 3.6.5.3

Income tax withheld in a different country

Company X performs consulting services for Company C, which is located in a different country from Company X. Company C withholds 20 per cent of Company X's fee as a local income tax withholding and transmits this amount to its local government on behalf of Company X (Company X retains the primary responsibility to pay the tax in Company C's tax jurisdiction). Company C pays the remaining 80 per cent to Company X. The countries do not have a tax treaty, and Company X is not required to file a tax return in Company C's country. Company X was fully aware that the 20 per cent income tax would be withheld in Company C's country when it agreed to perform the consulting services for Company C.

If Company X's fee is CU100 and Company C remits CU80 to Company X and CU20 to the local government, does Company X have revenue of CU100 and tax expense of CU20 or net revenue of CU80?

Company X is the principal in providing the consulting services to Company C. Company X also has the primary responsibility to pay the tax in Company C's tax jurisdiction, and Company C is simply paying the tax on Company X's behalf (acting as a collection agent). Consequently, Company X should recognise revenue in the gross amount of consideration to which it expects to be entitled in exchange for those services and should therefore report revenue of CU100 and income tax expense of CU20.



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3.6.5.4 Shipping and handling costs charged to customers

Many vendors charge customers for shipping and handling of goods. Shipping costs include costs incurred to move the product from the seller's place of business to the buyer's designated location and include payments to third-party shippers. But they may also include costs incurred directly by the seller (e.g. salaries and overheads related to the activities to prepare the goods for shipment).

Handling costs include costs incurred to store, move and prepare the products for shipment. Generally, handling costs are incurred from when the product is removed from finished goods inventories to when the product is provided to the shipper and may include an allocation of internal overheads.

Shipping and handling costs may be included in the price of the product. Alternatively, the vendor may charge its customers a separate fee for shipping and handling costs. In some cases, the separate fee may be a standard amount that does not necessarily correlate directly with the costs incurred for the specific shipment. In other cases, the separate fee may be a direct reimbursement for shipping and any direct incremental handling costs incurred or may include a margin on top of those costs.

For example, Company S sells goods to a customer and bills the customer for shipping and handling costs. Company S needs to consider how to present the amounts billed for shipping and handling in profit or loss.

The appropriate presentation of amounts billed to a customer for shipping and handling will depend on an analysis of the principal versus agent considerations in IFRS 15 related to shipping and handling services (see [3.6.1](#) to [3.6.3](#)). If control of the goods transfers on receipt by the customer (e.g. FOB destination – see [9.4.6](#)), the vendor will generally be considered to be the principal in the shipping and handling service. If, however, control of the goods transfers when the goods are shipped, the vendor will need to determine whether it is principal or agent with respect to the shipping service.

If, after consideration of the requirements of IFRS 15:B34 to B38 (see [3.6.1](#) to [3.6.3](#)), Company S determines that it is responsible for shipping and handling as a principal, then all amounts related to shipping and handling billed to a customer in a sale transaction represent revenues earned for the goods provided (and the shipping services rendered, if the shipping service represents a distinct performance obligation) and should be presented as revenue.

However, if Company S considers the requirements of IFRS 15:B34 to B38 and determines that it is not responsible to the customer for shipping but is instead acting merely as the buyer's agent in arranging for a third party to provide shipping services to the buyer, then Company S should not report the amount charged by that third party for shipping as its own revenue. Instead, Company S should report as revenue only the commission it receives (if any) for arranging shipping, which is the excess of any amounts charged to the customer for shipping by Company S over any amounts paid to the third party for those services.



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Example 3.6.5.4

Classification of shipping costs incurred on products sold

Company A sells and ships goods to a customer and has concluded that it is the principal on the sale of goods and associated shipping. Company A analyses expenses by function in its statement of comprehensive income.

How should Company A classify costs incurred for shipping goods to customers?

Company A may adopt a policy of including shipping and handling costs in cost of sales. This treatment is permitted by paragraph 38 of IAS 2 *Inventories*, which states that the circumstances of the entity may warrant the inclusion of distribution costs in cost of sales.

Alternatively, shipping and handling costs may be included in a separate 'distribution costs' classification or, if insignificant, in 'other operating expenses'. Company A should ensure that:

- the classification is appropriate to the entity's circumstances;
- the classification is consistent from year to year; and
- material items are separately identified, as required by paragraph 97 of IAS 1 *Presentation of Financial Statements*.

3.6.5.5 Value added tax rebate

Example 3.6.5.5

Value added tax rebate

In Country C, when software is sold to distributors or end users, software developers are required to collect 17 per cent value added tax (VAT) as agents for the government (this rate is consistent with VAT on other similar items). As a measure to subsidise the software development industry, 14 per cent is rebated by the government to the developer almost immediately.

Assume software is sold by Entity S for CU117 inclusive of VAT. The sales invoice indicates a sales price of CU100 before VAT, with VAT of CU17 corresponding to the 17 per cent VAT rate. As a result of the sale, Entity S receives a rebate of CU14 from the government.

How much revenue should Entity S recognise?

In accordance with IFRS 15:47 (see **7.1**), CU17 is excluded from revenue because it is being collected on behalf of a third party. Therefore, Entity S should recognise a total of CU100 as revenue. Paragraph 3 of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* defines a government grant as "assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity". The 14 per cent VAT rebate is regarded as a government grant to encourage the software development industry. Therefore, Entity S should recognise revenue of CU100 and government grant income of CU14. In accordance with IAS 20:29, the CU14 may be presented separately or as 'other income'.



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3.7 Repurchase agreements

3.7.1 Repurchase agreements – general

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. [IFRS 15:B64]

Repurchase agreements generally come in three forms:

[IFRS 15:B65]

- an entity's obligation to repurchase the asset (a forward contract – see **3.7.2**);
- an entity's right to repurchase the asset (a call option – see **3.7.2**); and
- an entity's obligation to repurchase the asset at the customer's request (a put option – see **3.7.3**).

3.7.2 Forward contracts and call options

3.7.2.1 Forward contracts and call options – general

If an entity has an obligation or a right to repurchase the asset (a forward contract 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. Therefore, the contract is accounted for as either:

[IFRS 15:B66]

- (a) a lease in accordance with IFRS 16 *Leases* (or, for entities that have not adopted IFRS 16, IAS 17) if the entity has an obligation or a right to repurchase the asset for an amount that is less than its original selling price, unless the contract is part of a sale and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity continues to recognise the asset and recognises a financial liability for any consideration received from the customer. The financial liability is accounted for in accordance with IFRS 9 (or for entities that have not yet adopted IFRS 9, IAS 39); or
- (b) a financing arrangement (as discussed below) if the entity has an obligation or a right to repurchase the asset for an amount that is equal to or more than its original selling price.

IFRS 15:B66(a) was amended in January 2016 by consequential amendments arising from IFRS 16 *Leases* (effective for annual periods beginning on or after 1 January 2019, with earlier application permitted). The amendments add specific guidance for circumstances when a repurchase agreement is part of a sale and leaseback transaction.

The time value of money should be considered when comparing the repurchase price with the selling price.

[IFRS 15:B67]

If the repurchase agreement is a financing arrangement, the entity should continue to recognise the asset and it should recognise a liability for any consideration received from the customer. The difference between the amount of consideration received from the customer and the amount of consideration to be paid to the customer should be recognised as interest and, if applicable, as processing or holding costs (e.g. insurance). [IFRS 15:B68]

If the option lapses unexercised, the liability is derecognised and a corresponding amount of revenue is recognised. [IFRS 15:B69]



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Example 3.7.2.1

Repurchase agreements (1)

[IFRS 15:IE315 – IE318, Example 62 (extract)]

An entity enters into a contract with a customer for the sale of a tangible asset on 1 January 20X7 for CU1 million.

Case A – Call option: financing

The contract includes a call option that gives the entity the right to repurchase the asset for CU1.1 million on or before 31 December 20X7.

Control of the asset does not transfer to the customer on 1 January 20X7 because the entity has a right to repurchase the asset and therefore the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Consequently, in accordance with [IFRS 15:B66(b)], the entity accounts for the transaction as a financing arrangement, because the exercise price is more than the original selling price. In accordance with [IFRS 15:B68], 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.

3.7.2.2 Sales with a right of refusal retained by the vendor

When a vendor sells an asset to a customer, the sales contract may provide that if, at some point in the future, the customer receives a bona fide offer to sell the asset to a third party and the customer plans to accept that offer, the original vendor can exercise an option to repurchase the asset by matching the offer made by the third party. This is often referred to as a 'right of first refusal'.

IFRS 15:B66 states that "[if] an entity has an obligation or a right to repurchase the asset (a forward or 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" (see **3.7.2.1**).

If a vendor retains a right of first refusal, this would not, on its own, prevent the customer from obtaining control of the asset (as defined in IFRS 15:33 – see **9.1.2**).

A right of first refusal as described above allows the vendor to influence who the customer subsequently sells the asset to but not whether, when or for how much such a sale is made. As such, the vendor's right does not limit the customer's ability to direct the use of the asset, or to obtain substantially all the remaining benefits from the asset.



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3.7.3 Put options

If an entity has an obligation to repurchase the asset at the customer's request (a put option) at a price that is lower than the original selling price of the asset, the entity should consider at inception of the contract whether the customer has a significant economic incentive to exercise that right. If the customer exercises the put option, it has in effect paid consideration to the entity for the right to use a specified asset for a period of time. Therefore, if the customer has a significant economic incentive to exercise the put option, the agreement is accounted for as a lease in accordance with IFRS 16 (or for entities that have not yet adopted IFRS 16, IAS 17), unless the contract is part of a sale and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity continues to recognise the asset and recognises a financial liability for any consideration received from the customer. The financial liability is accounted for in accordance with IFRS 9 (or for entities that have not yet adopted IFRS 9, IAS 39). [IFRS 15:B70]

IFRS 15:B70 was amended in January 2016 by consequential amendments arising from IFRS 16 *Leases* (effective for annual periods beginning on or after 1 January 2019, with earlier application permitted). The amendments add specific guidance for circumstances when a put option is part of a sale and leaseback transaction.

Various factors should be considered to determine whether a customer has a significant economic incentive to exercise a put option, including the relationship of the repurchase price to the expected market value of the asset at the date of the repurchase and the amount of time until the option expires. For example, if it is expected that the repurchase price will significantly exceed the market value of the asset, this indicates that the customer may have a significant economic incentive to exercise the put option. [IFRS 15:B71]

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 is accounted for as described at **3.7.2**. [IFRS 15:B73]

The agreement will be accounted for as if it were a sale of a product with a right of return (see **7.2.2**) if either:

- the customer does not have a significant economic incentive to exercise the option at a price that is lower than the original selling price of the asset; [IFRS 15:B72] or
- 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 option. [IFRS 15:B74]

When comparing the repurchase price with the selling price, an entity should consider the time value of money. [IFRS 15:B75]

If the option lapses unexercised, the entity should derecognise the liability and recognise revenue. [IFRS 15:B76]



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Example 3.7.3

Repurchase agreements (2)

[IFRS 15:IE315 & IE319 – IE321, Example 62 (extract)]

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 [IFRS 15:B70 to B76]). 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 [IFRS 15:B70 to B71], the entity accounts for the transaction as a lease in accordance with IFRS 16 *Leases* [(or, for an entity that has not yet adopted IFRS 16, IAS 17)].

3.8 Application of IFRS 15 guidance under other Standards

The requirements of IFRS 15 used to (1) assess when control of an asset passes from an entity (see **section 9**), and (2) measure any consideration (see **section 7**) for the purposes of calculating the profit or loss on the disposal of an asset, should be applied when any of the following types of asset are disposed of:

- property, plant and equipment in the scope of IAS 16 *Property, Plant and Equipment*;
- intangible assets in the scope of IAS 38 *Intangible Assets*; and
- investment properties in the scope of IAS 40 *Investment Property*.

When the amount of consideration to be included in calculating the gain or loss subsequently changes, this is accounted for in accordance with the requirements for changes in the transaction price in IFRS 15 (see **7.1** and **7.2**).



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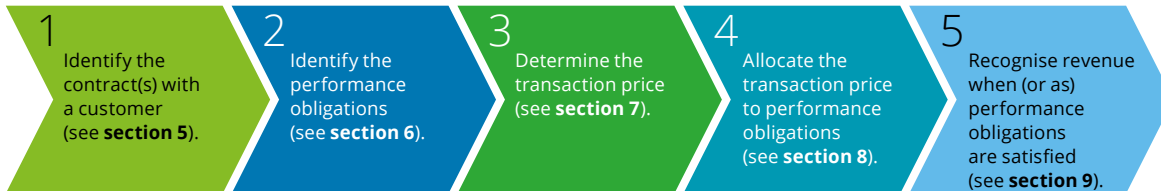
Section 4. The five-step model for recognising revenue from contracts with customers



Section 4. The five-step model for recognising revenue from contracts with customers

The introduction to IFRS 15 explains that an entity recognises revenue by applying a model consisting of five steps in order to meet the Standard's core principle (see **3.2**). The five steps are as follows.

[IFRS 15:IN7]



While these five steps are stated sequentially in the introduction to IFRS 15, they are neither labelled as such nor dealt with in this order in either the body of the Standard or in Appendix B – Application Guidance. In a manner consistent with other IFRSs, the requirements of IFRS 15 adhere to the framework of recognition, measurement, presentation and disclosure. As a result, the steps are not presented sequentially in IFRS 15 but rather as follows:

- recognition – this deals with the requirements of Step 1 (identification of a contract), Step 2 (identifying separate performance obligations) and Step 5 (recognition of revenue when (or as) the entity satisfies a performance obligation); and
- measurement – this deals with the requirements of Step 3 (determination of the transaction price) and Step 4 (allocation of the transaction price to the performance obligations in the contract).

Application of all five steps

Generally, an entity should consider all five steps for every contract. However, the entity may find that, after considering the specific facts and circumstances of a particular contract, one of the steps is not relevant. This may occur, for example, in a contract for which the entity has determined in Step 2 that it has only a single performance obligation. In such circumstances, Step 4 (allocation of the transaction price) will often not be applicable and the entity can, in effect, jump from Step 3 to Step 5.

Order of the steps

An entity would generally be expected to apply the five steps in sequential order. However, the entity may sometimes need to consider a later step before applying an earlier one.



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Consider the following examples:


- In applying Step 1 to determine whether a contract exists and reviewing the collectability threshold as required in IFRS 15:9(e) (see **5.1**), an entity will need to consider the “amount of consideration to which it will be entitled in exchange for the promised goods or services”. The amount of consideration “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”. As a result, the entity would need to apply Step 3 (determination of the transaction price) and estimate the expected discounts or price concessions before being able to conclude that a valid contract exists under Step 1.
- In Step 2 (identification of the performance obligations), IFRS 15:22(b) requires entities to identify as a performance obligation “a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer” (see **6.1.1**). In accordance with IFRS 15:23, that series is a performance obligation only when the two criteria are met: (1) the performance obligation satisfies the criteria in Step 5 to be recognised over time, and (2) the same method to measure progress is used. Therefore, the determination in Step 2 as to whether a series of distinct goods or services is a performance obligation relies on the requirements in Step 5. As a result, an entity would need to understand and make a determination about Step 5 before being able to apply Step 2 (the identification of its performance obligations).

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Section 5. Step 1: Identify the contract(s) with a customer

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Identify the contract(s) with a customer

Section 5. Step 1: Identify the contract(s) with a customer

5.1 Identification of the contract – general

5.1.1 Criteria for a contract to be accounted for in accordance with the general requirements of IFRS 15

IFRS 15:9 sets out five criteria for the initial determination as to whether a contract with a customer should be accounted for under the general requirements of the Standard (IFRS 15:15 (see **5.3**) sets out specific requirements when the criteria in IFRS 15:9 are not met).

Entities are required to account for a contract with a customer that is within the scope of IFRS 15 only when the all of the following criteria are met:

[IFRS 15:9]

- (a) the contract has been approved (either in writing, orally, or in accordance with other customary business practices) by the parties to the contract, and the parties 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 to be transferred to the customer.

In contrast, IAS 18 does not include explicit requirements for a contract to exist.

5.1.2 Approval/enforceability

A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. As noted at IFRS 15:9(a), contracts can be written, oral or implied by an entity's customary business practices. Practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. They may also vary within an entity (e.g. they may depend on the class of customer or the nature of the promised goods or services). Such practices and processes will need to be considered to determine whether and when an agreement with a customer creates enforceable rights and obligations. [IFRS 15:10]

In some cases, contracts with customers may have no fixed duration and may be capable of being terminated or modified by either party at any time. Alternatively, contracts may automatically renew on a periodic basis that is specified in the contract. IFRS 15 should be applied for the duration of the contract (i.e. the contractual period) in which the parties to the contract have present enforceable rights and obligations. [IFRS 15:11]



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Identify the contract(s) with a customer

A question arises as to whether it is appropriate for an entity to apply the revenue recognition model in IFRS 15 when it does not yet have a written sales agreement, but a written sales agreement is being prepared.

An entity applies the revenue recognition model in IFRS 15 when there is an agreement between two or more parties that creates enforceable rights and obligations. Whether the agreed terms are written, oral or evidenced otherwise (e.g. by the entity's customary business practices), a contract exists if the agreement creates rights and obligations that are enforceable against the parties. Determining whether a contractual right or obligation is enforceable is a question of law and the factors that determine enforceability may differ between jurisdictions. The best evidence of an enforceable agreement is a written contract, especially if the seller's standard practice is to use written contracts.

Although IFRS 15 does not require a written contract as evidence of an agreement, a contract that is being prepared but has not yet been signed may be evidence that agreement has not yet been reached. Entities should use caution before recognising revenue in such circumstances, because the apparent absence of a contractual understanding between the parties may make it unlikely that the conditions in IFRS 15:9 have been met.

5.1.3 Collectability

5.1.3.1 Impact of price concessions

IFRS 15:9(e) requires an evaluation as to whether it is probable that the entity will collect the consideration to which it is entitled under the contract. In order to make this assessment, the entity should only consider the customer's ability and intention to pay the consideration when it is due. It may be the case that the consideration to which an entity is ultimately entitled will be less than the price stated in the contract, because the customer may be offered a price concession. In such cases, the entity will need to apply IFRS 15's guidance on variable consideration (see **7.1** and **7.2**). [IFRS 15:9(e)]

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An entity should use judgement and consider all relevant facts and circumstances to determine whether, at contract inception, the consideration stated in the contract should be reduced for the effects of a price concession, due to either:


- the customer having a valid expectation arising from the 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 (i.e. it is expected that the entity will offer a price concession); or
- other facts and circumstances indicating that the entity's intention, when entering into the contract with the customer, is to offer a price concession to the customer.

If either of these is the case, then (as noted in IFRS 15:52 – see **7.2.1**) the consideration due under the contract is variable as a result of a price concession and the entity should determine whether the collectability criterion in IFRS 15:9(e) is met by reference to the net expected consideration (i.e. the consideration stated in the contract as reduced by the expected price concession).

Otherwise, the assessment of the collectability criterion should be based on whether, at inception, collection of the full amount due under the contract is considered probable.



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Identify the contract(s) with a customer

Example 5.1.3.1A**Consideration is not the stated price – implicit price concession**

[IFRS 15:IE7 – IE9, Example 2]

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 [IFRS 15:9(e)] is met, the entity also considers [IFRS 15:47 and IFRS 15:52(b) (see **section 7**)]. 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 [IFRS 15:9(e)] 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 [IFRS 15:9] are also met. Consequently, the entity accounts for the contract with the customer in accordance with the requirements in IFRS 15.

Example 5.1.3.1B**Implicit price concession**

[IFRS 15:IE10 – IE13, Example 3]

An entity, a hospital, provides medical services to an uninsured patient in the emergency room. The entity has not previously provided medical services to this patient but is required by law to provide medical services to all emergency room patients. Because of the patient's condition upon arrival at the hospital, the entity provides the services immediately and, therefore, before the entity can determine whether the patient is committed to perform its obligations under the contract in exchange for the medical services provided. Consequently, the contract does not meet the criteria in [IFRS 15:9] and, in accordance with [IFRS 15:14], the entity will continue to assess its conclusion based on updated facts and circumstances.

After providing services, the entity obtains additional information about the patient including a review of the services provided, standard rates for such services and the patient's ability and intention to pay the entity for the services provided. During the review, the entity notes its standard rate for the services provided in the emergency room is CU10,000. The entity also reviews the patient's information and to be consistent with its policies designates the patient to a customer class based on the entity's assessment of the patient's ability and intention to pay.

Before reassessing whether the criteria in [IFRS 15:9] have been met, the entity considers [IFRS 15:47 and IFRS 15:52(b) (see **section 7**)]. Although the standard rate for the services is CU10,000 (which may be the amount invoiced to the patient), the entity expects to accept a lower amount of consideration in exchange for the services. Accordingly, the entity concludes that the transaction price is not CU10,000 and, therefore, the promised consideration is variable. The entity reviews its historical cash collections from this customer class and other relevant information about the patient. The entity estimates the variable consideration and determines that it expects to be entitled to CU1,000.


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In accordance with [IFRS 15:9(e)], the entity evaluates the patient's ability and intention to pay (ie the credit risk of the patient). On the basis of its collection history from patients in this customer class, the entity concludes it is probable that the entity will collect CU1,000 (which is the estimate of variable consideration). In addition, on the basis of an assessment of the contract terms and other facts and circumstances, the entity concludes that the other criteria in [IFRS 15:9] are also met. Consequently, the entity accounts for the contract with the patient in accordance with the requirements in IFRS 15.

5.1.3.2 Collectability assessed at individual contract level

TRG

If an entity has a portfolio of contracts that are all similar, including in terms of collectability, and historical evidence suggests that a proportion of the consideration due from contracts in the portfolio will not be collected, the collectability criterion should be assessed at the individual contract level and not by assessing the expected level of collectability for the portfolio to estimate the number of contracts that will not meet the criterion. For each individual contract, if it is considered probable that the entity will collect the consideration to which it will be entitled, the general requirements of IFRS 15 should be applied.

For example, if an entity has a portfolio of 100 similar contracts and historical experience has indicated that the entity will only collect amounts due on 98 of those contracts, this does not suggest that there are two contracts that should not be accounted for under the general requirements of IFRS 15. Rather, the entity should consider collectability in the context of the individual contracts. If there is a 98 per cent probability that amounts due under each individual contract will be collected, then each contract will meet the criterion in IFRS 15:9(e).

Consideration should, however, be given to any evidence that collection of amounts due under any specific contract is not probable. If that is considered to be the case, that specific contract does not meet the collectability criterion and should be accounted for in accordance with IFRS 15:15 (see **5.3**).


When a contract meets the criteria in IFRS 15:9, including collectability, the entity recognises revenue as it satisfies its performance obligations under the contract based on the amount of consideration to which the entity expects to be entitled (rather than the amount it expects to collect). Therefore, for example, if the entity expects to be entitled to consideration of CU500 from each of its contracts, it should recognise that CU500 as revenue, notwithstanding its historical experience of a 2 per cent level of default.

Any associated receivable or contract asset would then be evaluated for impairment, with any difference between the measurement of the contract asset or receivable and the corresponding amount of revenue being presented as an expense in accordance with IFRS 9 *Financial Instruments* (or, for entities that have not yet adopted IFRS 9, IAS 39 *Financial Instruments: Recognition and Measurement*).

In the circumstances under consideration, this will result in revenue recognised of CU50,000 (CU500 × 100) and, assuming the estimated 98 per cent collection rate proves accurate, impairment (bad debts) of CU1,000 (CU50,000 × 2%).



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Identify the contract(s) with a customer

5.1.4 Contract that is wholly unperformed

A contract does not exist if each party to the contract has a unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties). A contract is wholly unperformed if both of the following criteria are met:

[IFRS 15:12]

- any promised goods or services have not yet been transferred to the customer; and
- the entity has not yet received, and is not yet entitled to receive, any consideration in exchange for promised goods or services.

5.2 Reassessing the criteria for identifying a contract

If, at the inception of a contract, the criteria to qualify for revenue recognition set out in IFRS 15:9 (see **5.1**) are met, an entity should not reassess those criteria unless there is an indication of a significant change in facts and circumstances. For example, if a customer's ability to pay the consideration deteriorates significantly, an entity would reassess whether it is probable that the entity will collect the consideration to which the entity will be entitled in exchange for the remaining goods or services that will be transferred to the customer. [IFRS 15:13]

TRG

If concerns arise regarding the collectability of the consideration due from a customer for a contract which has previously met the criteria in IFRS 15:9, an entity is not always required to reassess whether the contract meets those criteria; reassessment is only appropriate when the concerns arise from a change in facts and circumstances that is considered to be significant.

Example 5.2 illustrates a scenario in which a change in the customer's financial condition is so significant that a reassessment of the criteria in IFRS 15:9 is required. The reassessment results in the collectability criterion not being met and, accordingly, the entity is precluded from recognising further revenue under the contract until collectability becomes probable or the criteria in IFRS 15:15 are met (see **5.3**). The entity also assesses any related contract assets or accounts receivable for impairment.

The same example also illustrates that the customer's credit risk might reasonably fluctuate during a contract term, especially a long-term contract, and that more minor changes do not necessarily call into question the validity of the contract.

Similarly, if a contract with a customer which has previously met the criteria in IFRS 15:9 is subsequently modified, an entity is not always required to reassess whether the contract meets those criteria. The nature of a contract modification and the circumstances in which it is made will determine whether it should be considered to be reflective of a significant change in facts and circumstances as contemplated in IFRS 15:13. For example, a contract modification may sometimes be caused by a significant deterioration in the customer's ability to pay (i.e. a change in the expectation of collectability since contract inception) which should be assessed as discussed in the previous paragraphs.

The required accounting for modifications of contracts that continue to meet the criteria in IFRS 15:9 is described in IFRS 15:18 to 21 (see **section 10**).



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Example 5.2

Reassessing the criteria for identifying a contract

[IFRS 15:IE14 – IE17, Example 4]

An entity licences a patent to a customer in exchange for a usage-based royalty. At contract inception, the contract meets all the criteria in [IFRS 15:9] and the entity accounts for the contract with the customer in accordance with the requirements in IFRS 15. The entity recognises revenue when the customer's subsequent usage occurs in accordance with [IFRS 15:B63 (see **11.3**)].

Throughout the first year of the contract, the customer provides quarterly reports of usage and pays within the agreed-upon period.

During the second year of the contract, the customer continues to use the entity's patent, but the customer's financial condition declines. The customer's current access to credit and available cash on hand are limited. The entity continues to recognise revenue on the basis of the customer's usage throughout the second year. The customer pays the first quarter's royalties but makes nominal payments for the usage of the patent in Quarters 2–4. The entity accounts for any impairment of the existing receivable in accordance with IFRS 9 *Financial Instruments*.

During the third year of the contract, the customer continues to use the entity's patent. However, the entity learns that the customer has lost access to credit and its major customers and thus the customer's ability to pay significantly deteriorates. The entity therefore concludes that it is unlikely that the customer will be able to make any further royalty payments for ongoing usage of the entity's patent. As a result of this significant change in facts and circumstances, in accordance with [IFRS 15:13], the entity reassesses the criteria in [IFRS 15:9] and determines that they are not met because it is no longer probable that the entity will collect the consideration to which it will be entitled. Accordingly, the entity does not recognise any further revenue associated with the customer's future usage of its patent. The entity accounts for any impairment of the existing receivable in accordance with IFRS 9 *Financial Instruments*.

For entities that have not yet adopted IFRS 9, the references in **example 5.2** would instead be to IAS 39 *Financial Instruments: Recognition and Measurement*.

If a contract with a customer does not meet the criteria in IFRS 15:9 (see **5.1**), the entity should continue to assess the contract to determine whether those criteria are subsequently met. [IFRS 15:14]

5.3 Accounting when the criteria for a contract are not met

If the criteria for revenue recognition in IFRS 15:9 (see **5.1**) are not met, but consideration is received from the customer, that consideration should be recognised as revenue only when either of the following events has occurred:

[IFRS 15:15]

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

When the entity has received consideration from a customer, but is unable to recognise revenue until either (1) one of the events in IFRS 15:15 occurs (see above), or (2) the criteria in IFRS 15:9 are subsequently met (see **5.2**), the consideration should be presented as a liability until such point that the entity is entitled to recognise the balance as revenue (see **section 13**). Depending on the specific facts and circumstances, the liability recognised represents an obligation of the entity to either transfer goods or services in the future or refund the consideration received. In both cases, the liability should be measured at the amount of consideration received from the customer. [IFRS 15:16]



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Example 5.3

Collectability criterion not met

[IFRS 15:IE3 – IE9, Example 1]

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

- (a) the customer intends to repay the loan (which has a significant balance) primarily from income derived from its restaurant business (which is a business facing significant risks because of high competition in the industry and the customer's limited experience);
- (b) the customer lacks other income or assets that could be used to repay the loan; and
- (c) the customer's liability under the loan is limited because the loan is non-recourse.

Because the criteria in [IFRS 15:9] are not met, the entity applies [IFRS 15:15 and 16] to determine the accounting for the non-refundable deposit of CU50,000. The entity observes that none of the events described in [IFRS 15:15] 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 [IFRS 15:16], 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 [IFRS 15:9] 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 [IFRS 15:15] has occurred. The entity continues to assess the contract in accordance with [IFRS 15:14] to determine whether the criteria in [IFRS 15:9] are subsequently met or whether the events in [IFRS 15:15] have occurred.



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Identify the contract(s) with a customer

5.4 Partial satisfaction of a performance obligation prior to identifying a contract

Guidance on the appropriate accounting when an entity commences activities on a specified contract prior to agreeing all of the contract terms with the customer or prior to the contract satisfying the identification criteria in IFRS 15:9 is set out at **9.3.5**.

5.5 Combining contracts

Two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) should be combined and accounted for as a single contract if one or more of the following criteria are met:

[IFRS 15:17]

- (a) the contracts are negotiated as a package with a single commercial objective;
- (b) the amount of consideration to be paid in one contract is dependent on the price or performance of the other contract; or
- (c) the goods or services promised in the contracts (or some of the goods or services promised in each of the contracts) are a single performance obligation (see **section 6**).

5.6 Modifying contracts

A contract may be modified after an entity has already accounted for some or all of the revenue relating to that contract. The impact on revenue recognition will depend on how that contract has been modified. This is discussed in **section 10**.




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Identify the performance obligations in the contract

Section 6. Step 2: Identify the performance obligations

6.1 Identification of performance obligations

6.1.1 Identification of performance obligations – general

Once an entity has established that it has a contract to which the five-step model can be applied, the next step is to assess whether there are goods or services promised in the contract that represent separate performance obligations. A separate performance obligation can be either:

[IFRS 15:22]

- (a) a good or service (or a bundle of goods or services) that is 'distinct' (see **6.3**); 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.

Proper identification of the performance obligations in a contract is critical to achieving the core principle in IFRS 15 (see **3.2**). Failure to identify and account for the separate performance obligations in a contract could result in the incorrect timing of revenue recognition.

The process of identifying the performance obligations in a contract, sometimes referred to as 'unbundling', is not optional. However, as a practical matter, it may not be necessary to apply the Standard's detailed requirements on unbundling if the amounts recognised and disclosed in the financial statements will be the same irrespective of whether unbundling is applied. For example, when control of two or more goods or two or more services is transferred at exactly the same time, or on the same basis over the same period of time, and if those items do not need to be segregated for disclosure purposes, then it will not be necessary to unbundle each of those concurrently delivered items, because the amount and timing of revenue recognised and disclosed would not differ if the items were unbundled.

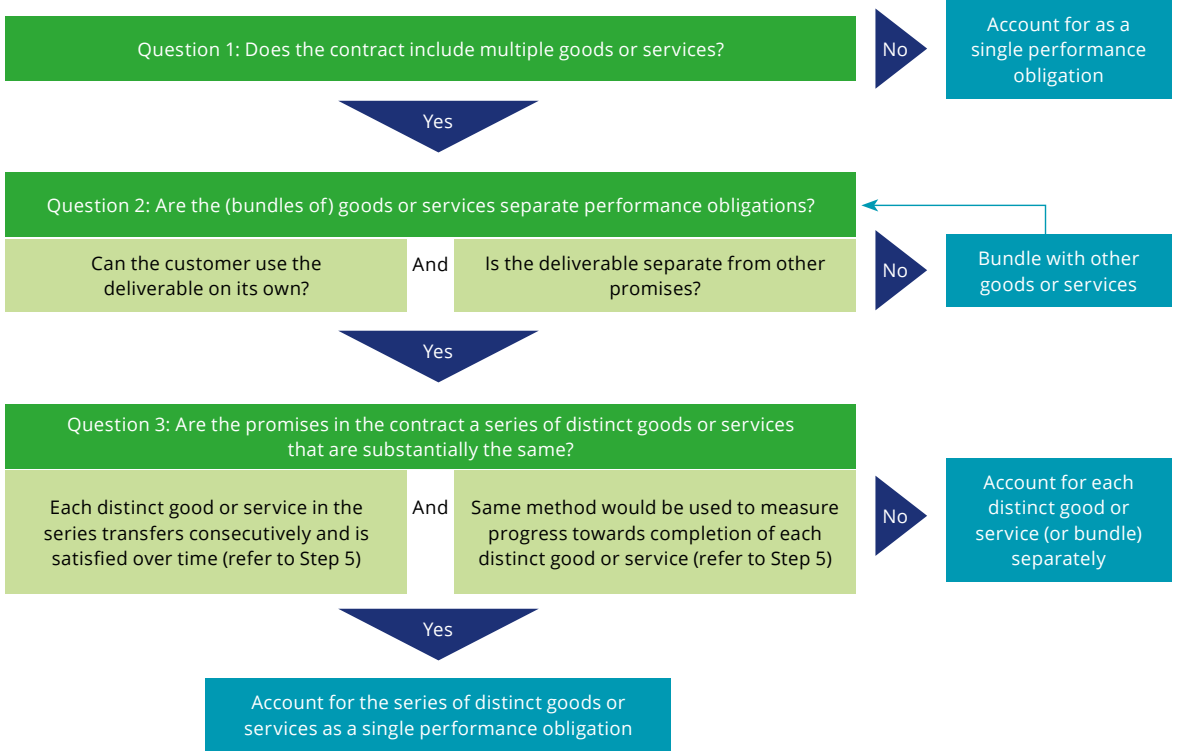
This step requires careful consideration. The following diagram sets out the key questions to assess by entities to identify whether there are separate performance obligations.



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Step 2. Identifying separate performance obligations



6.1.2 Series of distinct goods or services accounted for as a separate performance obligation

Illustrative Example 25 accompanying IFRS 15 provides an example of a series of distinct goods or services as described in IFRS 15:22(b) (see **example 7.3C**).

A series of distinct goods or services has the same pattern of transfer to the customer (as contemplated in IFRS 15:22(b) – see **6.1.1**) if both of the following criteria are met:

[IFRS 15:23]

- (a) each distinct good or service in the series that the entity promises to transfer to the customer meets the criteria in IFRS 15:35 to be a performance obligation satisfied over time (see **9.2**); and
- (b) in accordance with IFRS 15:39 and 40 (see **9.3**), 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.

The notion of a performance obligation is similar to the notions of deliverables, components or elements of a contract in the Standards superseded by IFRS 15. Although the notion of a performance obligation is implicit in those Standards, the term 'performance obligation' has not been defined previously.
[IFRS 15:BC84]

Moreover, although IAS 18:13 refers to 'separately identifiable components' of a transaction, IAS 18 includes almost no guidance on how to identify such components.



TRG

The TRG discussed a number of issues relating to the application of IFRS 15:22(b), as follows.

- The application of IFRS 15:22(b) does not require the same accounting result to be produced as a situation in which each of the underlying distinct goods or services were accounted for as separate performance obligations.
- The criteria in IFRS 15:23 must be met for an entity to conclude that a series of two or more goods or services is a single performance obligation. The series requirement is intended to simplify the application of the revenue model in IFRS 15 to promote consistency in identification of performance obligations.
- If an entity concludes that a series of distinct goods or services meets the requirements of IFRS 15:22(b), it is required to treat that series as a single performance obligation and is not permitted to regard the distinct goods or services in the series as individual performance obligations. IFRS 15:BC113 clarifies the IASB's intent to mandate the use of this simplification, stating that the Board "decided to specify that a promise to transfer a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer *would be a single performance obligation* if two criteria are met" (emphasis added).
- For an entity to determine that the series requirement in IFRS 15:22(b) is met, and, specifically, that goods or services have the 'same pattern of transfer to the customer', the goods or services do not have to be transferred consecutively. Neither of the criteria in IFRS 15:23 refers to the consecutive transfer of goods or services to the customer and, therefore, the applicability of IFRS 15:22(b) does not depend on whether the goods (services) will be delivered (performed) consecutively.

For example, an entity might enter into a contract to provide the same package of cleaning services each consecutive week for 52 weeks. Alternatively, the cleaning contract might envisage that some services are not provided in certain weeks but are provided in other weeks on an overlapping basis whereby cleaning begins before the previous week's work has been completed. Both of the criteria in IFRS 15:23 could be met in each of the cleaning contract examples.

The TRG concluded that, for distinct goods or services to be considered to be *substantially the same* and therefore accounted for as a series under IFRS 15:22(b), it is not necessary for the tasks in each increment to be substantially the same.

The evaluation of whether distinct goods or services are substantially the same requires significant judgement based on the relevant facts and circumstances of the contract.

An entity should first determine the nature of the promised goods or services to be provided under the contract by evaluating whether the nature of the arrangement is to provide the customer with a specified quantity of distinct goods or services or to stand ready to provide an undefined quantity of goods or services over the duration of the contract period.

If the nature of the promise is the delivery of a specified quantity of a service, then the evaluation should consider whether each service is distinct and substantially the same. If the nature of the entity's promise is the act of standing ready or providing a single service for a period of time (because there is an unspecified quantity to be delivered), the evaluation would focus on whether each time increment is distinct and substantially the same, rather than the underlying activities.

Examples 6.1.2A to 6.1.2C illustrate different circumstances in which an entity determines that a series of distinct goods or services are substantially the same.



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Identify the performance obligations in the contract

Example 6.1.2A

Series of distinct goods or services that are substantially the same – specified quantity of distinct goods or services

Company A provides Customer Z with monthly payroll processing services for one year and concludes that each monthly service (1) is distinct, (2) meets the criteria for recognising revenue over time, and (3) has the same method for measuring progress. In addition, it is concluded that the arrangement is to provide the customer with a specified quantity of distinct goods or services (i.e. 12 distinct instances of payroll processing).

Having determined that it is to provide 12 distinct services, Company A determines that even though the exact volume of employee payroll data processed may vary each month, the benefit consumed by the customer (i.e. the processing of payroll for that month) is substantially the same for each monthly transaction.

Therefore, Company A concludes that the monthly payroll services are substantially the same and satisfy the requirements of IFRS 15:22(b) to be accounted for as a single performance obligation.

Example 6.1.2B

Series of distinct goods or services that are substantially the same – undefined services over the contract period (hotel management services)

Company B provides hotel management services to Customer Y that include hiring and managing employees, procuring goods and services, and advertising and marketing the hotel. On a given day, Company B could clean guest rooms, perform marketing efforts to increase occupancy, and operate the concierge desk.

Company B concludes that the nature of the contract is to provide integrated hotel management services over the term of the contract and not a specific quantity of specified services (i.e. it is not specified that 100 guest rooms must be cleaned per day). The underlying activities in providing the hotel management services can vary significantly from day to day; however, the daily services are activities that are required to satisfy Company B's obligation to provide an integrated hotel management service. Therefore, the integrated service of hotel management transferred to the customer is substantially the same during each period because Customer Y receives substantially the same benefit each period (i.e. there is the same pattern of transfer to the customer).

Company B concludes that each increment of service (i.e. day or week) is distinct, meets the criteria for recognising revenue over time, and has the same method for measuring progress and, therefore, that the hotel management services satisfy the criteria in IFRS 15:22(b) to be accounted for as a single performance obligation.



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Example 6.1.2C

Series of distinct goods or services that are substantially the same – undefined services over the contract period (IT outsourcing services)

Company C provides information technology (IT) outsourcing services to Customer X for a five-year period. The IT outsourcing services include providing Customer X with server capacity, maintenance of the customer's software portfolio, and access to an IT help desk.

Company C considers the nature of the promise to Customer X and concludes that it is to provide continuous access to an integrated outsourced IT solution and not to provide a specified quantity of services (e.g. processing 100 transactions per day). The underlying activities in providing IT outsourcing services can vary significantly day to day; however, the daily services are activities performed to fulfil Company C's integrated IT outsourcing service and are, therefore, substantially the same. Company C concludes that, for each period, (1) it is providing an integrated IT outsourcing service; (2) the customer is continuously receiving substantially the same benefit, which is distinct (i.e. there is the same pattern of transfer to the customer); and (3) each increment of time is substantially the same (i.e. the same integrated IT outsourcing solution is provided in each time period).

Company C concludes that each distinct increment of time meets the criteria for recognising revenue over time and has the same method of measuring progress. Therefore, Company C concludes that the IT outsourcing services satisfy the criteria in IFRS 15:22(b) to be accounted for as a single performance obligation.

6.1.3 Identification of performance obligations – economic compulsion and optional items

TRG

Some business models include arrangements under which a vendor will sell an upfront good or service and also provide the customer with an option to purchase other distinct goods or services in the future that are related to the upfront good or service (e.g. a specialised piece of equipment and an option to buy specialised consumables that will be needed for its operation). Such arrangements may include features that result in a degree of economic compulsion such that there is a very high level of confidence that the customer will exercise its option.

The additional goods or services should not be treated as performance obligations under the contract, even in such circumstances when it is highly probable, or even virtually certain that the customer will exercise its option. The treatment of customer options is explained in IFRS 15:BC186, in which the boards clarified that "the transaction price does not include estimates of consideration from the future exercise of options for additional goods or services", making no reference to the probability that those options will be exercised. Accordingly, irrespective of how likely it is that a customer will choose to purchase additional goods or services, the reporting entity should not treat those goods or services as performance obligations under the initial contract. Instead, the entity should evaluate the customer option to determine whether it gives rise to a material right (see 6.3.5).

6.2 Promises in contracts with customers

6.2.1 Explicit and implicit promises in a contract

The goods or services that will be transferred to the customer are usually explicitly stated in the contract. 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 when, 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. [IFRS 15:24]



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Identify the performance obligations in the contract

Example 6.2.1 Explicit and implicit promises in a contract

[IFRS 15:IE59 – IE65A, Example 12]

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

Case A – Explicit promise of service

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

The contract with the customer includes two promised goods or services – (a) the product and (b) the maintenance services. The promise of maintenance services is a promise to transfer goods or services in the future and is part of the negotiated exchange between the entity and the distributor. The entity assesses whether each good or service is distinct in accordance with [IFRS 15:27 (see 6.3)]. The entity determines that both the product and the maintenance services meet the criterion in [IFRS 15:27(a)]. The entity regularly sells the product on a stand-alone basis, which indicates that the customer can benefit from the product on its own. The customer can benefit from the maintenance services together with a resource the customer already has obtained from the entity (ie the product).

The entity further determines that its promises to transfer the product and to provide the maintenance services are separately identifiable (in accordance with [IFRS 15:27(b)] on the basis of the principle and the factors in [IFRS 15:29 (see 6.3)]). The product and the maintenance services are not inputs to a combined item in the contract. The entity is not providing a significant integration service because the presence of the product and the services together in this contract do not result in any additional or combined functionality. In addition, neither the product nor the services modify or customise the other. Lastly, the product and the maintenance services are not highly interdependent or highly interrelated because the entity would be able to fulfil each of the promises in the contract independently of its efforts to fulfil the other (ie the entity would be able to transfer the product even if the customer declined maintenance services and would be able to provide maintenance services in relation to products sold previously through other distributors). The entity also observes, in applying the principle in paragraph [IFRS 15:29], that the entity's promise to provide maintenance is not necessary for the product to continue to provide significant benefit to the customer. Consequently, the entity allocates a portion of the transaction price to each of the two performance obligations (ie the product and the maintenance services) in the contract.

Case B – Implicit promise of service

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

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



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Identify the performance obligations in the contract

Case C – Services are not a promised service

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

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

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

6.2.2 Contract activities that are not performance obligations

An activity that is undertaken to fulfil a contract is not a performance obligation unless it transfers 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 set-up activities are not a performance obligation. [IFRS 15:25]

6.2.3 Pre-production activities

TRG

In some long-term supply arrangements, before goods can be delivered to the customer, an entity may be required to undertake pre-production activities such as 'upfront' engineering and design (e.g. to create new technology or adapt existing technology to the needs of the customer). Because of the nature of the underlying tasks, pre-production activities are often carried out over a period of time.

If a pre-production activity transfers a good or service to the customer as it is carried out, then (subject to the other requirements of IFRS 15) it will be appropriate to recognise revenue as the pre-production activity is carried out. Such a pre-production activity could be a performance obligation in its own right or could form part of a larger performance obligation.

If the pre-production activity does not transfer a good or service to a customer as it is carried out, then no revenue will be recognised as the activity is carried out. Instead, the associated costs should either be capitalised, if they meet the criteria in IFRS 15:95 (see **12.3.1**), or expensed as incurred.

An entity should identify the nature of its promise(s) to the customer in order to determine whether the pre-production activity represents either:

- a promised good or service (or part of a promised good or service) that transfers to the customer; or
- a fulfilment activity that does not transfer a good or service to the customer.



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In making this distinction, an entity will need to apply judgement. In addition to the guidance on identifying performance obligations (see **6.1**), an entity might look to the guidance on satisfying a performance obligation over time (see **9.2**).

One scenario in which a performance obligation is satisfied over time is when the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (IFRS 15:35(a) – see **9.2.1**). If the customer simultaneously receives and consumes benefits as the entity carries out the pre-production activity, this would indicate that the pre-production activity forms part of (or is) a performance obligation. In accordance with IFRS 15:B4 (see **9.2.2**), when making an assessment as to whether the condition in IFRS 15:35(a) is met, it may be helpful to consider whether another entity would need to substantially re-perform the pre-production activities if that other entity were to fulfil the remaining performance obligation to the customer. For the purpose of such an assessment, it should be assumed that the other entity would not have the benefit of any asset that would continue to be controlled by the entity if the contract were terminated.


Another scenario in which a performance obligation is satisfied over time is when the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced. If the pre-production activity creates or enhances an asset that the customer controls as the asset is created or enhanced, this would indicate that the pre-production activity forms part of (or is) a performance obligation.

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Example 6.2.3**Assessing whether a pre-production activity forms part of the delivery of a promised good or services**

An entity enters into a contract with a customer to develop and produce a new product. As part of its development of the new product for the customer, the entity performs engineering and development activities. The contract terms specify that the customer will own the intellectual property (patents) that results from those activities. Thus, the entity determines that the engineering and development activities create an asset that the customer controls as it is created. Accordingly, the entity concludes that the engineering and development activities transfer a good or service to the customer over time, and that those activities form part of the performance obligation(s) in the contract with the customer.


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6.3 Distinct goods or services

6.3.1 Determining whether goods or services are 'distinct'

Promised goods or services may include, among other items:

[IFRS 15:26]

- (a) sale of goods produced by an entity (e.g. inventory of a manufacturer);
- (b) resale of goods purchased by an entity (e.g. merchandise of a retailer);
- (c) resale of rights to goods or services purchased by an entity (e.g. a ticket resold by an entity acting as a principal – see **3.6**);
- (d) performing a contractually agreed-upon task (or tasks) for a customer;
- (e) providing 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 (see **6.3.7**);
- (f) providing a service of arranging for another party to transfer goods or services to a customer (e.g. acting as an agent of another party – see **3.6**);
- (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 **section 11**); and
- (j) granting options to purchase additional goods or services that provide the customer with a material right (see **6.3.5**).

Both of the following criteria must be met in order for a good or service to be classified as distinct:

[IFRS 15:27]

- (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 (i.e. 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 (i.e. the promise to transfer the good or service is distinct within the context of the contract).

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


Various factors may provide evidence that the customer can benefit from a good or service either on its own or in conjunction with other readily available resources. If an entity regularly sells a good or service separately, this indicates that a customer can benefit from the good or service on its own or with other readily available resources.

[IFRS 15:28]

When considering the criterion in IFRS 15:27(b) (see above), the objective is to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. Factors which indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include:



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[IFRS 15:29]

- (a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit;
- (b) one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract; and
- (c) the goods or services are highly interdependent or highly interrelated (i.e. each of the goods or services is significantly affected by one or more of the other goods or services in the contract). For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfil its promise by transferring each of the goods or services independently.

Example 6.3.1

Determining whether goods or services are distinct

[IFRS 15:IE49 – 58K, Example 11]

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

The entity also considers the principle and the factors in [IFRS 15:29] 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 [IFRS 15:27(b)] is met).

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



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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 [IFRS 15:31 to 38 (see **section 9**)] 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 [IFRS 15:B58 (see **11.2**)].

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 [IFRS 15:27]. The entity first assesses whether the criterion in [IFRS 15:27(a)] has been met. For the same reasons as in Case A, the entity determines that the software licence, installation, software updates and technical support each meet that criterion. The entity next assesses whether the criterion in [IFRS 15:27(b)] has been met by evaluating the principle and the factors in [IFRS 15:29]. 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 [IFRS 15:29(a)]). The software is significantly modified and customised by the service (see [IFRS 15:29(b)]). Consequently, the entity determines that the promise to transfer the licence is not separately identifiable from the customised installation service and, therefore, the criterion in [IFRS 15:27(b)] is not met. Thus, the software licence and the customised installation service are not distinct.

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


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

- (a) software customisation (which comprises the licence for the software and the customised installation service);
- (b) software updates; and
- (c) technical support.

The entity applies [IFRS 15:31 to 38 (see **section 9**)] to determine whether each performance obligation is satisfied at a point in time or over time.



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Case C – Promises are separately identifiable (installation)

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

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

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

- (a) The entity is not providing a significant integration service. That is, the entity has promised to deliver the equipment and then install it; the entity would be able to fulfil its promise to transfer the equipment separately from its promise to subsequently install it. The entity has not promised to combine the equipment and the installation services in a way that would transform them into a combined output.
- (b) The entity's installation services will not significantly customise or significantly modify the equipment.
- (c) Although the customer can benefit from the installation services only after it has obtained control of the equipment, the installation services do not significantly affect the equipment because the entity would be able to fulfil its promise to transfer the equipment independently of its promise to provide the installation services. Because the equipment and the installation services do not each significantly affect the other, they are not highly interdependent or highly interrelated.


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

- (i) the equipment; and
- (ii) installation services.

The entity applies [IFRS 15:31 to 38 (see **section 9**)] to determine whether each performance obligation is satisfied at a point in time or over time.



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Case D – Promises are separately identifiable (contractual restrictions)

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

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

Case E – Promises are separately identifiable (consumables)

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

The entity determines that the customer can benefit from the equipment together with the readily available consumables. The consumables are readily available in accordance with [IFRS 15:28], because they are regularly sold separately by the entity (ie through refill orders to customers that previously purchased the equipment). The customer can benefit from the consumables that will be delivered under the contract together with the delivered equipment that is transferred to the customer initially under the contract. Therefore, the equipment and the consumables are each capable of being distinct in accordance with [IFRS 15:27(a)].

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


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

- (a) the equipment; and
- (b) the consumables.

The entity applies [IFRS 15:31 to 38 (see **section 9**)] to determine whether each performance obligation is satisfied at a point in time or over time.



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6.3.2 No exemption from accounting for goods or services considered to be perfunctory or inconsequential

An entity may enter into a contract in which it promises to transfer Product A and Item B to a customer. Product A and Item B meet the criteria in IFRS 15:27 to be considered distinct and do not meet the criteria in IFRS 15:22(b) (i.e. they do not constitute a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer (see **6.1.1**)). Item B may be either a substantive promise in the arrangement (e.g. free maintenance on Product A for two years) or inconsequential (e.g. a promise to participate in a joint committee, delivery of an installation or training manual, a simple installation process that only requires unpacking and plugging in, a simple inspection service).

IFRS 15:BC89 and BC90 clarify that all goods or services promised to a customer as a result of a contract give rise to performance obligations because those promises were made as part of the negotiated exchange between the entity and its customer.

Although the entity may consider some of those goods or services to be marketing incentives or incidental goods or services, they are goods or services for which the customer pays and to which the entity should allocate consideration for revenue recognition purposes if they meet the definition of a performance obligation. Although Item B may be considered to be perfunctory or inconsequential, it cannot be ignored. Instead, an entity would assess whether the performance obligation is immaterial to its financial statements as described in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

6.3.3 Goods and services that are not distinct

If a promised good or service is not distinct, an entity combines that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, that will result in all the goods or services promised in a contract being accounted for as a single performance obligation. [IFRS 15:30]

Example 6.3.3

Goods and services are not distinct

[IFRS 15:IE45 – IE48C, Example 10]

Case A – Significant integration service

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


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

However, the promises to transfer the goods and services are not separately identifiable in accordance with [IFRS 15:27(b)] (on the basis of the factors in [IFRS 15:29]). 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 [IFRS 15:27] 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.



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Case B – Significant integration service

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

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

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

6.3.4 Warranties

Entities often provide a warranty in connection with the sale of a product (whether a good or service). The nature of that warranty can vary significantly across industries and contracts. Some warranties provide the customer with assurance that the related product will function as the parties intended because it complies with agreed-upon specifications (an 'assurance-type' warranty). Other warranties provide the customer with a service in addition to the assurance that the product complies with agreed-upon specifications (a 'service-type' warranty). [IFRS 15:B28]

When the customer can purchase a warranty separately (e.g. because the warranty is priced or negotiated separately), the warranty is a distinct service because the entity has promised to provide that service in addition to the product that has the functionality described in the contract. In such circumstances, the promised warranty is accounted for as a separate performance obligation. This will require a portion of the transaction price to be allocated to the warranty service provided (see **section 8**). [IFRS 15:B29]




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If a customer *does not* have the option to purchase a warranty separately, the warranty still includes a separate performance obligation if it provides the customer with a service in addition to the entity's assurance that the goods or services transferred will function as intended or meet agreed-upon specifications (see below).



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When the customer cannot purchase a warranty separately, it should be accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* unless the promised warranty, or a part of the promised warranty, is a service-type warranty. [IFRS 15:B30]

When considering whether a service-type warranty is being provided, an entity considers factors such as:

[IFRS 15:B31]

- (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 a service-type warranty exists because it is more likely to provide a service in addition to the assurance that the product complies with the agreed-upon specifications; and
- (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 an assurance-type warranty (e.g. a return shipping service for a defective product), then those tasks are likely not to give rise to a performance obligation.

If a warranty, or a part of a warranty, is a service-type warranty, it is accounted for as a separate performance obligation and a portion of the transaction price is allocated to the warranty. If an entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, both warranties should be accounted for together as a single performance obligation. [IFRS 15:B32]

A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. For example, a manufacturer might sell products in a jurisdiction in which the law holds the manufacturer liable for any damages (e.g. to personal property) that might be caused by a consumer using a product for its intended purpose. Similarly, an entity's promise to indemnify the customer for liabilities and damages arising from claims of patent, copyright, trademark or other infringement by the entity's products does not give rise to a performance obligation. Such obligations should be accounted for in accordance with IAS 37. [IFRS 15:B33]

Example 6.3.4A

Assurance-type warranty accounted for under IAS 37

In accordance with customary business practices, a luggage manufacturer provides all customers with a non-optional one-year warranty that covers only manufacturing defects.

This warranty does not represent a separate performance obligation; it only provides assurance that the luggage will function as intended because it complies with agreed-upon specifications. This is an assurance-type warranty which should be accounted for under IAS 37. No portion of the transaction price is allocated to the warranty.



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Example 6.3.4B**Assurance-type warranty accounted for under IAS 37 and service-type warranty accounted for as a separate performance obligation**

A luggage manufacturer provides all customers with a life-time warranty that covers all defects and damages, including those arising from normal 'wear and tear'.

In addition to the assurance-type warranty accounted for under IAS 37 (as discussed in **example 6.3.4A**), this arrangement also includes a service-type warranty which should be accounted for as a separate performance obligation because the manufacturer has agreed to provide repairs for all damage (i.e. it has agreed to provide a service of repairing the luggage for all damage, which extends beyond rectifying manufacturing defects). The luggage manufacturer should determine the stand-alone selling price of the repair service and allocate an appropriate portion of the transaction price to it, and recognise that portion as revenue over the period of time during which the service is delivered.

Example 6.3.4C**Warranties**

[IFRS 15:IE223 – IE229, Example 44]

An entity, a manufacturer, provides its customer with a warranty with the purchase of a product. The warranty provides assurance that the product complies with agreed-upon specifications and will operate as promised for one year from the date of purchase. The contract also provides the customer with the right to receive up to 20 hours of training services on how to operate the product at no additional cost.

The entity assesses the goods and services in the contract to determine whether they are distinct and therefore give rise to separate performance obligations.

The product and training services are each capable of being distinct in accordance with [IFRS 15:27(a) & 28], because the customer can benefit from the product on its own without the training services and can benefit from the training services together with the product that already has been transferred by the entity. The entity regularly sells the product separately without the training services.

The entity next assesses whether its promises to transfer the product and to provide the training services are separately identifiable in accordance with [IFRS 15:27(b) and 29]. The entity does not provide a significant service of integrating the training services with the product (see [IFRS 15:29(a)]). The training services and product do not significantly modify or customise each other (see [IFRS 15:29(b)]). The product and the training services are not highly interdependent, or highly interrelated (see [IFRS 15:29(c)]). The entity would be able to fulfil its promise to transfer the product independently of its efforts to subsequently provide the training services, and would be able to provide training services to any customer that had previously acquired its product. Consequently, the entity concludes that its promise to transfer the product and its promise to provide training services are not inputs to a combined item, and, therefore, are each separately identifiable.


The product and training services are each distinct in accordance with [IFRS 15:27] and therefore give rise to two separate performance obligations.

Finally, the entity assesses the promise to provide a warranty and observes that the warranty provides the customer with the assurance that the product will function as intended for one year. The entity concludes, in accordance with [IFRS 15:B28 to B33], that the warranty does not provide the customer with a good or service in addition to that assurance and, therefore, the entity does not account for it as a performance obligation. The entity accounts for the assurance-type warranty in accordance with the requirements in IAS 37.

As a result, the entity allocates the transaction price to the two performance obligations (the product and the training services) and recognises revenue when (or as) those performance obligations are satisfied.



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6.3.5 Customer options for additional goods or services (material rights)

6.3.5.1 Customer options for additional goods or services – general

Customer options to acquire additional goods or services for free or at a discount come in many forms, including sales incentives, customer award credits (or points), contract renewal options or other discounts on future goods or services. [IFRS 15:B39]

When a contract grants the customer an option to acquire additional goods or services, that option gives rise to a performance obligation in the contract only when it provides a material right to the customer that the customer would not have received without entering into that contract (e.g. a discount is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right to the customer, the customer is, in effect, paying the entity in advance for future goods or services. Therefore the entity should defer the recognition of revenue allocated to that option until those future goods or services are transferred, or when the option expires. [IFRS 15:B40]

If the amount that the customer would pay for the additional good or service reflects the stand-alone selling price for that good or service, the option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract. In these circumstances, the entity has merely made a marketing offer, and it will account in accordance with IFRS 15 only when the customer exercises the option to purchase the additional goods or services. [IFRS 15:B41]

6.3.5.2 Evaluating whether a contract option provides a material right

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Entities regularly grant options for additional goods and services (e.g. sales incentives or discounts on future goods or services) to customers in the ordinary course of business. As discussed by the TRG, the evaluation of whether such options provide a material right (and, consequently, give rise to a separate performance obligation) should consider both quantitative and qualitative factors. This is consistent with the notion in IFRS 15:BC87 that an entity should consider its customer's valid expectations when identifying promised goods or services, and that a customer's perspective on what constitutes a material right might consider qualitative factors.

Further, when evaluating whether a customer option gives rise to a material right, an entity should consider all facts and circumstances, including those that exist outside of the current transaction with the customer. This may include consideration of current, past and future transactions with the customer, including how a right accumulates over time.

Consider, for example, an entity with a loyalty programme that allows customers to accumulate points upon each purchase of goods or services. The points accumulated can then be redeemed to obtain future goods or services from the entity.

In assessing whether this option to redeem points to purchase additional goods or services provides the customer with a material right, the entity evaluates current, past and future transactions made by the customer in addition to both quantitative and qualitative factors – in particular, whether the material right accumulates over time (i.e. after multiple transactions). The number of loyalty points awarded to a customer in any given transaction may not be quantitatively material, but the fact that the loyalty programme has been designed to influence customer behaviour may be a qualitative indicator that the option provides a material right.



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Example 6.3.5.2

Option that does not provide the customer with a material right (additional goods or services)

[IFRS 15:IE254 – IE256, Example 50]

An entity in the telecommunications industry enters into a contract with a customer to provide a handset and monthly network service for two years. The network service includes up to 1,000 call minutes and 1,500 text messages each month for a fixed monthly fee. The contract specifies the price for any additional call minutes or texts that the customer may choose to purchase in any month. The prices for those services are equal to their stand-alone selling prices.

The entity determines that the promises to provide the handset and network service are each separate performance obligations. This is because the customer can benefit from the handset and network service either on their own or together with other resources that are readily available to the customer in accordance with the criterion in [IFRS 15:27(a)]. In addition, the handset and network service are separately identifiable in accordance with the criterion in [IFRS 15:27(b)] (on the basis of the factors in [IFRS 15:29]).

The entity determines that the option to purchase the additional call minutes and texts does not provide a material right that the customer would not receive without entering into the contract (see [IFRS 15:B41]). This is because the prices of the additional call minutes and texts reflect the stand-alone selling prices for those services. Because the option for additional call minutes and texts does not grant the customer a material right, the entity concludes it is not a performance obligation in the contract. Consequently, the entity does not allocate any of the transaction price to the option for additional call minutes or texts. The entity will recognise revenue for the additional call minutes or texts if and when the entity provides those services.

6.3.5.3 Allocating the transaction price to customer options for additional goods or services

IFRS 15:74 requires an entity to allocate the transaction price to performance obligations on a relative stand-alone selling price basis (see **section 8**). If the stand-alone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity is required to estimate it. The estimate should reflect the discount that the customer would obtain when exercising the option, adjusted for both:

[IFRS 15:B42]

- (d) any discount that the customer could receive without exercising the option; and
- (e) the likelihood that the option will be exercised.

IFRS 15 provides a practical alternative to estimating the stand-alone selling price in limited circumstances (see **6.3.5.4**).



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Example 6.3.5.3A
Option that provides the customer with a material right (discount voucher)

[IFRS 15:IE250 – IE253, Example 49]

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

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

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

Performance obligation	Stand-alone selling price	
	CU	
Product A	100	
Discount voucher	12	
Total	112	
	Allocated transaction price	
Product A	89	(CU100 ÷ CU112 × CU100)
Discount voucher	11	(CU12 ÷ CU112 × CU100)
Total	100	

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



Identify the performance obligations in the contract

Example 6.3.5.3B

Option to purchase goods at a discount – vouchers available with or without the requirement to make an initial purchase

In an effort to increase sales, Supermarket B offers two separate marketing programmes to its customers:

Programme 1 – All visitors to Supermarket B can, irrespective of whether they make any other purchases, pick up a voucher entitling them to a reduction of CU1 from the usual CU10 selling price of Product X.

Programme 2 – Customers who purchase Product W for its normal selling price of CU7 will receive a voucher entitling them to a reduction of CU5 from Product X's selling price.

Only one voucher can be used for any purchase of Product X. It has been determined that the option granted to purchasers of Product W to purchase Product X for CU5 instead of CU9 (i.e. the purchase price when the CU1 voucher is redeemed) gives those customers a material right.

How should Supermarket B account for the two different types of vouchers?

The CU1 vouchers issued under Programme 1 are not within the scope of IFRS 15. Because the customer does not enter into any enforceable commitment by picking up a CU1 voucher, no contract arises from the CU1 vouchers.

As a result, Supermarket B should simply treat the CU1 vouchers as a price reduction when customers use the CU1 vouchers to purchase Product X. Therefore, if a customer uses a CU1 voucher to purchase Product X for CU9, the revenue recognised will be CU9 because that is the consideration to which Supermarket B is entitled in exchange for Product X (when the CU1 vouchers are taken into account).

The CU5 vouchers issued under Programme 2 are, however, within the scope of IFRS 15 because customers are entitled to the CU5 vouchers as part of a sales transaction (i.e. the contract to purchase Product W).

In accounting for the CU5 vouchers, Supermarket B should therefore consider IFRS 15:B39 to B43. In accordance with those paragraphs, because a CU5 voucher gives the customer a material right that it would not receive without entering into the contract to purchase Product W, a separate performance obligation is established.

In assessing the stand-alone selling price of the CU5 vouchers (in accordance with IFRS 15:B42 – see above), Supermarket B should consider (1) that customers not making a purchase could still have claimed a CU1 voucher (the incremental value of the CU5 voucher to the customer would therefore be CU4), and (2) the likelihood that the CU5 voucher will be redeemed.

Accordingly, the stand-alone selling price of the CU5 vouchers that will be used to allocate the transaction price of CU7 between Product W and the performance obligation for the discount voucher will not exceed the additional discount of CU4, and may be lower depending on the proportion of vouchers expected to be redeemed. The entity recognises revenue related to the CU5 vouchers when Product X is transferred to a customer, taking into account the guidance in IFRS 15:B44 to B47 (see **7.7.3**) on vouchers not expected to be redeemed.



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6.3.5.4 Practical alternative when option is to acquire additional similar goods or services

IFRS 15 provides a practical alternative to estimating the stand-alone selling price of an option when the customer has a material right to acquire future goods or services and those goods or services are similar to the original goods or services in the contract and are provided in accordance with the terms of the original contract. In such circumstances, the transaction price can be allocated to the optional goods or services by reference to the goods or services expected to be provided and the corresponding expected consideration. This simplified approach is illustrated in IFRS 15 Illustrative Example 51, which is reproduced as **example 6.3.5.4**. These options are typically for contract renewals. [IFRS 15:B43]

Example 6.3.5.4

Option that provides the customer with a material right (renewal option)

[IFRS 15:IE257 – IE266, Example 51]

An entity enters into 100 separate contracts with customers to provide one year of maintenance services for CU1,000 per contract. The terms of the contracts specify that at the end of the year, each customer has the option to renew the maintenance contract for a second year by paying an additional CU1,000. Customers who renew for a second year are also granted the option to renew for a third year for CU1,000. The entity charges significantly higher prices for maintenance services to customers that do not sign up for the maintenance services initially (ie when the products are new). That is, the entity charges CU3,000 in Year 2 and CU5,000 in Year 3 for annual maintenance services if a customer does not initially purchase the service or allows the service to lapse.

The entity concludes that the renewal option provides a material right to the customer that it would not receive without entering into the contract, because the price for maintenance services are significantly higher if the customer elects to purchase the services only in Year 2 or 3. Part of each customer’s payment of CU1,000 in the first year is, in effect, a non-refundable prepayment of the services to be provided in a subsequent year. Consequently, the entity concludes that the promise to provide the option is a performance obligation.

The renewal option is for a continuation of maintenance services and those services are provided in accordance with the terms of the existing contract. Instead of determining the stand-alone selling prices for the renewal options directly, the entity allocates the transaction price by determining the consideration that it expects to receive in exchange for all the services that it expects to provide, in accordance with [IFRS 15:B43].

The entity expects 90 customers to renew at the end of Year 1 (90 per cent of contracts sold) and 81 customers to renew at the end of Year 2 (90 per cent of the 90 customers that renewed at the end of Year 1 will also renew at the end of Year 2, that is 81 per cent of contracts sold).

At contract inception, the entity determines the expected consideration for each contract is CU2,710 [CU1,000 + (90 per cent × CU1,000) + (81 per cent × CU1,000)]. The entity also determines that recognising revenue on the basis of costs incurred relative to the total expected costs depicts the transfer of services to the customer. Estimated costs for a three-year contract are as follows:

	CU
Year 1	600
Year 2	750
Year 3	1,000





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

	Expected costs adjusted for likelihood of contract renewal		Allocation of consideration expected	
	CU	CU	CU	CU
Year 1	600	(CU600 × 100%)	780	(CU600/CU2,085 × CU2,710)
Year 2	675	(CU750 × 90%)	877	(CU675/CU2,085 × CU2,710)
Year 3	810	(CU1,000 × 81%)	1,053	(CU810/CU2,085 × CU2,710)
Total	2,085		2,710	

Consequently, at contract inception, the entity allocates to the option to renew at the end of Year 1 CU22,000 of the consideration received to date [cash of CU100,000 – revenue to be recognised in Year 1 of CU78,000 (CU780 × 100)].

Assuming there is no change in the entity’s expectations and the 90 customers renew as expected, at the end of the first year, the entity has collected cash of CU190,000 [(100 × CU1,000) + (90 × CU1,000)], has recognised revenue of CU78,000 (CU780 × 100) and has recognised a contract liability of CU112,000.

Consequently, upon renewal at the end of the first year, the entity allocates CU24,300 to the option to renew at the end of Year 2 [cumulative cash of CU190,000 less cumulative revenue recognised in Year 1 and to be recognised in Year 2 of CU165,700 (CU78,000 + CU877 × 100)].

If the actual number of contract renewals was different than what the entity expected, the entity would update the transaction price and the revenue recognised accordingly.

6.3.5.5 Distinguishing between optional purchases and variable consideration

TRG As discussed at 6.3.5.1 to 6.3.5.3, if a contract includes an option for a customer to obtain ‘additional goods or services’, that option is evaluated to determine whether it represents a material right. If so, part of the transaction price is allocated to the material right and recognition of that portion of revenue is deferred. Delivery of such additional goods or services is not itself a performance obligation under the contract; instead, the option to acquire those goods or services is treated as a performance obligation if it represents a material right. Any additional consideration that may arise if the customer exercises the option is not included in the transaction price of the initial contract.



TRG

IFRS 15 deals separately with the appropriate accounting for 'variable consideration', when the consideration promised in a contract includes a variable amount (see **7.2**). The amount of variable consideration ultimately payable can depend on a wide variety of factors. In particular, if variability in the quantities of goods or services supplied under the contract affects the amount of consideration due under the contract then, in some (but not all) circumstances, this will be treated as variable consideration. An estimate of variable consideration is then included in the transaction price of the contract (albeit, subject to the constraint discussed at **7.2.8**). An entity will need to evaluate the nature of its promises under a contract and apply judgement to determine whether the contract includes an option to purchase additional goods or services (which would need to be evaluated to determine whether it represents a material right), or whether the contract includes a performance obligation for which the quantity of goods or services to be delivered is not fixed at the outset (and would, therefore, be treated as variable consideration).

In the case of an option for additional goods or services, the customer has a present right to choose to purchase additional distinct goods or services. Prior to the customer exercising that right, the entity is not obliged to provide those goods or services and the customer is not obliged to pay for them.

In the case of variable consideration for promised goods or services, the entity is obliged to transfer those goods or services and the customer is obliged to pay for them. The future events that result in additional consideration occur after, or as, control of the goods or services has transferred or as it transfers.

In exercising judgement, the following indicators may be helpful.

- If the customer has a separate purchasing decision to make in respect of additional *distinct* goods or services, and the vendor is not obliged to provide those goods or services if the customer does not exercise its rights, this would be indicative of an option for additional goods or services. For example, an entity enters into a five-year exclusive master supply agreement with a customer for components that the customer uses in its products. The customer may purchase components at any time during the agreement, but it is not obliged to purchase any components. Each time the customer elects to purchase a component, this represents a separate performance obligation with the supplier.
- Conversely, if future events (which may include the customers' own actions) will not oblige the vendor to provide additional *distinct* goods or services (because the nature of the promise is an overall service, with the associated variable goods or services not being distinct), then any additional consideration triggered by those events will be accounted for as variable consideration. For example, an entity may agree that it will process all transactions for a customer, with fees being based, in part, on the volume of transactions processed, but that volume of transactions is not known at the outset and will depend on factors outside the control of both the entity and the customer. In this case, the performance obligation is to provide the customer with an overall service of transaction processing for the contract period, and the individual transactions processed are not distinct services, but rather are part of satisfaction of the single performance obligation to process all transactions.



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6.3.5.6 Options for additional goods or services that do not expire

An entity may provide a customer with an option to acquire additional goods or services that is a material right to the customer and that has no expiry date. The requirements of IFRS 15 are not affected by whether the material right has an expiry date. Therefore, the appropriate accounting for an option that has no expiry date will depend on whether the material right is (1) included in a portfolio of similar rights provided by the entity, or (2) accounted for as an individual right. However, it is likely that when there is no expiry date to the material right, greater judgement will be required when assessing the extent to which options are likely to be exercised in the future.

If the material right is included in a portfolio of similar rights, revenue related to expected unexercised options should be recognised in proportion to the pattern of rights exercised by the customers in the portfolio (see **example 6.3.5.6A**).

If the customer option is an individual right, the entity would recognise revenue attributed to the unexercised material right when the likelihood that the customer will exercise the option is remote (see **6.3.5.6B**).

See **7.7** for further guidance on customers' unexercised rights ('breakage').

Example 6.3.5.6A

Recognition of revenue related to options that do not expire – loyalty points

An entity has a loyalty rewards programme that offers customers 1 loyalty point per CU1 spent; points awarded to the customers do not expire. Customers can redeem 10 points in exchange for CU1 off future purchases of the entity's products.

During a reporting period, customers purchase products for CU100,000 (which reflects the stand-alone selling price of the products) and earn 100,000 points that are redeemable against future purchases. The entity expects 95,000 points to be redeemed.

The points provide a material right to the customers that they would not receive without entering into a contract (see **6.3.5.2**). Therefore, the entity concludes that the promise to provide points to the customer is a performance obligation.

The entity estimates the stand-alone selling price to be CU0.095 per point (totalling CU9,500) on the basis of the likelihood of redemption in accordance with IFRS 15:B42 (see **6.3.5.3**).

At contract inception, the entity allocates the transaction price of CU100,000 as follows.

- Products = CU91,324 (CU100,000 × CU100,000 stand-alone selling price ÷ CU109,500)
- Loyalty points = CU8,676 (CU100,000 × CU9,500 stand-alone selling price ÷ CU109,500)

A contract liability of CU8,676 is recognised for loyalty points granted.

End of Year 1

After one year, 20,000 points have been redeemed, and the entity continues to expect a total of 95,000 points to be redeemed. Therefore, the entity recognises revenue of CU1,827 for the 20,000 points redeemed (20,000 points redeemed ÷ 95,000 total points expected to be redeemed × CU8,676). The contract liability balance for the unredeemed points at the end of year 1 is CU6,849 (CU8,676 – CU1,827).



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End of Year 2

After two years, 50,000 points in total have been redeemed. The entity then reassesses the number of points that it expects the customers to redeem. Its new expectation is that 70,000 points will be redeemed in total. To calculate the revenue recognised in respect of the material right in Year 2, the entity determines what portion of the original revenue allocated to the material right (CU8,676) should have been cumulatively recognised by the end of Year 2 based on the new expectation that only 70,000 points will be redeemed, and then deducts the revenue already recognised in Year 1 in respect of the material right. Therefore, the entity recognises CU4,370 in revenue in Year 2 ($50,000 \text{ total points redeemed} \div 70,000 \text{ total points expected to be redeemed} \times \text{CU8,676} - \text{CU1,827}$ recognised in Year 1). The contract liability balance for the unredeemed points at the end of Year 2 is CU2,479 ($\text{CU6,849} - \text{CU4,370}$).

End of Year 3

After three years, 55,000 points in total have been redeemed, and the entity continues to expect that the customers will redeem 70,000 points in total. Therefore, the entity recognises CU620 in revenue in Year 3 for the 5,000 points redeemed ($55,000 \text{ total points redeemed} \div 70,000 \text{ total points expected to be redeemed} \times \text{CU8,676} - \text{CU1,827}$ recognised in Year 1 – CU4,370 recognised in Year 2). The contract liability balance for the unredeemed points at the end of year 3 is CU1,859 ($\text{CU2,479} - \text{CU620}$).

End of Year 4

After four years, no further points have been redeemed and the entity concludes that the likelihood that the customers will redeem any of the remaining points is remote. The total revenue recognised in respect of the material right in Year 4 would be the remaining contract liability balance of CU1,859.

Example 6.3.5.6.B

Recognition of revenue related to options that do not expire – single customer option

An entity enters into a contract with a customer for the sale of Product A for CU100. As part of the negotiated transaction, the customer also receives a coupon for 50 per cent off the sale of Product B; the coupon does not expire. Similar coupons have not been offered to other customers.

The entity concludes that the option to purchase Product B at a discount of 50 per cent provides the customer with a material right (see 6.3.5.2). Therefore, the entity concludes that (1) this option is a performance obligation, and (2) a portion of the transaction price should be allocated to this option.

The stand-alone selling price of Product B is CU60. The entity estimates a 70 per cent likelihood that the customer will redeem the coupon. On the basis of the likelihood of redemption, the stand-alone selling price of the coupon is estimated to be CU21 ($\text{CU60 sales price of Product B} \times 50 \text{ per cent discount} \times 70 \text{ per cent likelihood of redemption}$) in accordance with IFRS 15.B42 (see 6.3.5.3).

At contract inception, the entity allocates the CU100 transaction price as follows.

- Product A = CU83 ($\text{CU100} \times \text{CU100 stand-alone selling price} \div \text{CU121}$)
- Product B = CU17 ($\text{CU100} \times \text{CU21 stand-alone selling price} \div \text{CU121}$)

The option is not exercised during the first four years after its issuance and no revenue is recognised in relation to the material right. At the end of Year 4, the entity determines that the likelihood the customer will redeem the coupon has become remote and recognises the CU17 as revenue in accordance with IFRS 15:B46 (see 7.7).



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6.3.5.7 Retailer-sponsored coupons provided immediately after a purchase transaction

Retail stores sometimes provide retailer-sponsored coupons to customers immediately after a customer transaction (sometimes referred to as 'Catalina' coupons). These coupons are printed at the register on the basis of an automated programme and handed to the customer after a purchase is completed; the automated programme determines whether to provide targeted coupons to the customer as a result of various factors, such as items purchased by the customer or the amount spent. The coupons given to the customer can only be used in future purchases, often of specified products.

In some cases, a customer may be capable of knowing in advance that they will be entitled to receive a particular coupon upon making a purchase. For example, a retailer may have advertised the fact that it is running a price-matching campaign under which customers will receive a coupon representing the difference between the price paid for the goods purchased and the price that would have been paid for those same goods if bought from a competitor. This coupon can then be redeemed against future purchases made by the customer from the entity.

Often, however, a customer may have little or no expectation when making a purchase either that they will receive a coupon from the retailer or what that coupon might be for.

Based on IFRS 15:B40 (see **6.3.5.1**), coupons of this nature give rise to a performance obligation only if they provide a material right that the customer would not receive without entering into the transaction. This implies that the discount on the future good or service typically should be part of the negotiated exchange under the existing contract with the customer. In order to determine whether the offer is part of the negotiated exchange under the existing contract, the retailer would look to IFRS 15:24 (see **6.2.1**), which states that "...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".

An entity will therefore need to apply judgement to the particular facts and circumstances in order to ascertain whether it has made a promise (e.g. through advertising campaigns or its customary business practices) which has created a valid expectation on the part of a customer that they will receive a particular coupon upon making a purchase. An entity may also wish to consider historical data regarding how many customers use coupons for discounts on future purchases as part of assessing whether that coupon has a significant value to the customer such that it might be a material right.

In the price-matching campaign example above, it is possible that the coupon to be redeemed against future purchases may give rise to a material right as part of the initial sale (see **6.3.5.2**) if the price-matching campaign has created a valid expectation on the part of the customer that they will receive a coupon for any excess amount paid as part of the current transaction.

However, if the customer has little or no expectation in respect of any coupons that they might receive from a retailer, it is unlikely that a material right exists as part of the initial sale. In particular, the possibility that they will receive a coupon for a discount on future purchases when making a purchase is unlikely to have influenced the customer's buying decision to any meaningful extent. In such cases, the coupon is instead similar to a targeted coupon distribution based on customer purchasing habits. Such coupons should be accounted for at the time of redemption in accordance with IFRS 15:72 (see **7.6.1**).



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6.3.5.8 Accounting for the exercise of an option that is a material right

TRG

When a contract with a customer includes a material right in the form of an option to acquire additional goods or services, IFRS 15:B39 to B43 require an entity to allocate part of the transaction price to that right and recognise the associated revenue when those future goods or services are transferred or when the option expires (see **6.3.5.1** and **6.3.5.3**).

The TRG considered how an entity should account for the customer's subsequent exercise of the right (the option) and concluded that the guidance in IFRS 15 supports two approaches (which are outlined below). Although most TRG members supported the use of Approach A, they agreed that Approach B could also be accepted. The method used should be applied consistently by an entity to similar types of material rights with similar facts and circumstances.

Approach A

The exercise of a material right should be accounted for as a continuation of the contract because the current contract contemplates the additional goods or services subject to the material right. Therefore, at the time a customer exercises a material right, an entity should update the transaction price of the contract to include any additional consideration to which the entity expects to be entitled as a result of the exercise. This additional consideration should be allocated to the performance obligation underlying the material right and recognised as revenue when or as this performance obligation is satisfied. Therefore, the amount allocated to the material right is added to any additional amounts payable as a consequence of the material right being exercised, and that total is allocated to the additional goods or services. The amounts previously allocated to the other goods and services in the contract are not revised.

Approach B

The exercise of a material right should be accounted for as a contract modification. The additional consideration received and/or the additional goods or services provided when a customer exercises a material right represent a change in the scope and/or price of the contract. An entity should apply the modification guidance in IFRS 15:18 to 21 (see **section 10**).

Example 6.3.5.8

Accounting for the exercise of a material right


Entity A enters into a contract with a customer to provide Product X for CU200 and Service Y for CU100. The contract also includes an option for the customer to purchase Service Z for CU300. The stand-alone selling prices of Product X, Service Y and Service Z are CU200, CU100 and CU450 respectively. Entity A concludes that the option to purchase Service Z at a discount provides the customer with a material right. Entity A's estimate of the stand-alone selling price of the option (after considering both the discount the customer would receive without the option and the likelihood that the option will be exercised, in accordance with IFRS 15:B42 – see **6.3.5.3**) is CU100.

Entity A allocates the CU300 transaction price (CU200 for Product X plus CU100 for Service Y) to each performance obligation under the contract as follows:

	Transaction price	Stand-alone selling price	Allocation	Allocation
	CU	CU	%	CU
Product X		200	50	150
Service Y		100	25	75
Option		100	25	75
	300	400	100	300



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Subsequently, when Entity A has delivered Product X and has delivered 60 per cent of Service Y, the customer exercises its option to purchase Service Z for CU300.

Approach A

Entity A updates the transaction price to reflect the additional consideration receivable from the customer. The additional CU300 payable following the exercise of the option is added to the amount of CU75 that was previously allocated to the option to purchase Service Z, giving a total of CU375. The amount of CU375 is recognised as revenue over the period over which Service Z is transferred.

No change is made to the amount of revenue allocated to Product X and Service Y. The revenue not yet recognised in respect of Service Y ($40\% \times \text{CU}75 = \text{CU}30$) is recognised as revenue over the remaining period over which Service Y is transferred to the customer.

Approach B

Entity A accounts for the customer's exercise of its option to purchase Service Z as a contract modification. Entity A does not account for the modification as a separate contract because the price of the contract does not increase by an amount that reflects the stand-alone selling price of Service Z (see **10.2**). Therefore, having determined that the remaining services to be provided following the modification are distinct from those transferred to the customer prior to the modification, Entity A applies IFRS 15:21(a) (see **10.3**). The revenue already recognised in respect of Product X (CU150) and 60 per cent of Service Y ($\text{CU}75 \times 60\% = \text{CU}45$) is not adjusted.

Following the modification, the revenue not yet recognised is:

	Allocation
	CU
Adjusted transaction price (CU300 + CU300)	600
Less: Revenue already recognised (CU150 + CU45)	(195)
Revenue not yet recognised	405

This is allocated to the remaining performance obligations as follows.

	Transaction price	Stand-alone selling price*	Allocation	Allocation
	CU	CU	%	CU
Service Y (40% x CU100)		40	8.2	33
Service Z		450	91.8	372
	405	490	100	405

* Entity A has re-considered the stand-alone selling prices of Service Y and Product X when the option is exercised and concluded that these have not changed since contract inception

No change is made to the amount of revenue allocated to Product X. The revenue not yet recognised in respect of Service Y (CU33) is recognised as revenue over the remaining period over which Service Y is transferred to the customer, while the CU372 allocated to Service Z is recognised as revenue over the period over which Service Z is transferred.



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6.3.5.9 Significant financing component existing as a result of a material right

When a contract with a customer includes a material right in the form of an option to acquire additional goods or services, an entity is required to allocate part of the transaction price to that right and recognise the associated revenue when those future goods or services are transferred or when the option expires (see 6.3.5.1 and 6.3.5.3).



An entity will need to consider whether a significant financing component exists as a result of an option in accordance with the guidance in IFRS 15:60 to 64 (see 7.4). A significant financing component would not exist if, for example, the timing of transfer of additional goods or services is at the customer’s discretion. In some circumstances, the practical expedient in IFRS 15:63 may be available (see 7.4.2).

Example 6.3.5.9 Significant financing component existing as a result of a material right

Entity C enters into a contract with a customer under which the customer will receive Product W immediately and will have the option to purchase Product X five years later. Under the contract, the customer is required to pay CU340 at the outset and a further CU300 five years later if it chooses to exercise the option.

The stand-alone selling prices of Product W and Product X are CU200 and CU600 respectively. Entity C concludes that the option to purchase Product X provides the customer with a material right. However, because the customer pays for the material right at the outset, but can only exercise the option five years later, Entity C also concludes that the contract includes a financing component which it judges to be significant. Entity C determines that the present value of the stand-alone selling price of the option is CU155.

Entity C allocates the CU340 transaction price between Product W and the option as follows:

	Transaction price	Stand-alone selling price	Allocation	Allocation
	CU	CU	%	CU
Product W		200	56.3	192
Option		155	43.7	148
	340	355	100	340



Identify the performance obligations in the contract

Accordingly, Entity C recognises revenue of CU192 when Product W is delivered, and recognises a liability of CU148 in relation to the material right.

Each year, Entity C unwinds the discount on the material right at the rate of 10 per cent as follows.

	Opening balance	Unwind of discount – interest expense	Closing balance
	CU	CU	CU
Year 1	148	15	163
Year 2	163	16	179
Year 3	179	18	197
Year 4	197	20	217
Year 5	217	22	239
		91	

Accordingly, over the five-year period, Entity C recognises a total interest expense of CU91. This is added to the price initially allocated to the option of CU148 to give the closing balance at the end of Year 5 of CU239.

At the end of Year 5, the customer exercises the option and pays an additional CU300. Entity C follows Approach A as described in 6.3.5.8 and allocates to Product X the balance of the material right (CU239) and the additional CU300 paid. Therefore, it recognises revenue of CU539 when Product X is delivered.

6.3.5.10 Customer loyalty programme operated by a third party

Example 6.3.5.10

Customer loyalty programme operated by a third party

Entity A, a retailer, participates in a customer loyalty programme operated by a third party (the CLP operator). Under the programme, Entity A grants loyalty points to customers who have registered to participate in the programme when they purchase merchandise from its stores. The points granted can then be used as part or full payment for any future purchase by the customer at any retailer participating in the programme (including, but not limited to, Entity A).

Entity A is obliged to pay cash of CU1 to the CLP operator, for each point granted to its customers and is entitled to receive cash (also of CU1 per point) from the CLP when a customer uses points (which may have been earned through purchases from Entity A or another participating retailer) against purchases at its stores.

Entity A makes a sale of Product X to a customer for which it receives CU50. Under the terms of the customer loyalty programme, this purchase entitles the customer to two points. Entity A is consequently obliged to pay the CLP operator CU2 in respect of these points.

Entity A should recognise revenue of CU48 for the sale of Product X, together with a liability of CU2 due to the CLP operator.



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In this scenario, Entity A does not control the transfer of loyalty points to the customer (indeed, it has no access to the points, only an obligation to pay the CLP operator for them on the customer's behalf) and is not primarily responsible for fulfilling the obligations that the points represent (because the CLP operator is responsible for administering the programme and making payments to retailers following the use of those points). In accordance with IFRS 15:B36 to B37 (see **3.6.2** and **3.6.3**), Entity A is therefore considered to be acting as an agent of the CLP operator in facilitating the CLP operator's sale of points to the customer.

As such, the CU2 collected on behalf of the CLP operator is excluded from the transaction price for the sale of Product X (the definition of which in IFRS 15:Appendix A excludes "amounts collected on behalf of third parties") and the contractual obligation to deliver cash to the CLP operator is instead recognised as a financial liability.

6.3.6 Non-refundable upfront fees

A customer may be charged a non-refundable upfront fee at or near contract inception (e.g. joining fees in health club membership contracts, activation fees in telecommunication contracts, setup fees in some services contracts and initial fees in some supply contracts). [IFRS 15:B48]

An entity should assess whether the fee relates to the transfer of a promised good or service which represents a separate performance obligation. Even though a non-refundable upfront fee can relate to an activity that the entity is required to undertake at or near contract inception to fulfil the contract, in many cases that activity does not result in the transfer of a promised good or service to the customer (see **6.2**). Instead, the upfront fee is an advance payment for future goods or services and is recognised as revenue when those future goods or services are provided. If the entity grants the customer the option to renew the contract and that option provides the customer with a material right (see **6.3.5**), the revenue recognition period is extended beyond the initial contractual period. [IFRS 15:B49]

If the non-refundable upfront fee relates to a good or service, the entity should evaluate whether to account for the good or service as a separate performance obligation. [IFRS 15:B50]

An entity may charge a non-refundable fee, some of which is to compensate for costs incurred in setting up a contract or other administrative costs. If those setup activities do not satisfy a performance obligation, the entity should disregard those activities (and related costs) when measuring progress to assess when to recognise revenue (see **9.3.3**). This is because those costs do not depict the transfer of services to the customer. It will also be necessary to consider whether the costs incurred in setting up a contract should be capitalised (see **12.3.1**). [IFRS 15:B51]

Under IFRS 15, the timing of recognition of revenue is not based on cash receipt or payment schedules. Instead, an entity recognises revenue when (or as) it satisfies a performance obligation by transferring control of a promised good or service to a customer.

When consideration is received by an entity before the related performance obligation is satisfied, the advance payment should not be recognised as revenue until that obligation is satisfied. Instead, the entity should recognise the consideration received as a contract liability (i.e. deferred revenue) in its statement of financial position.



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Example 6.3.6A

Non-refundable upfront fee

[IFRS 15:IE272 – IE274, Example 53]

An entity enters into a contract with a customer for one year of transaction processing services. The entity's contracts have standard terms that are the same for all customers. The contract requires the customer to pay an upfront fee to set up the customer on the entity's systems and processes. The fee is a nominal amount and is non-refundable. The customer can renew the contract each year without paying an additional fee.

The entity's setup activities do not transfer a good or service to the customer and, therefore, do not give rise to a performance obligation.

The entity concludes that the renewal option does not provide a material right to the customer that it would not receive without entering into that contract (see [IFRS 15:B40]). The upfront fee is, in effect, an advance payment for the future transaction processing services. Consequently, the entity determines the transaction price, which includes the non-refundable upfront fee, and recognises revenue for the transaction.

Example 6.3.6B

Upfront fees received upon entering into a contract – club membership fees

An entity operates a fitness club. The key terms of its contractual arrangements with customers are as follows.

- Customers are required to pay a joining fee of CU100 upon entering into the contract.
- Each contract has a term of one year. During the contractual period, customers are required to pay a monthly fee of CU100 (irrespective of their usage of the club during that month).
- The joining fee is not refundable, even if the customer never uses the club during the one-year contract period.

Should the entity recognise the joining fee as revenue when it is received, on the basis that it is non-refundable?

No. Under IFRS 15, an entity should recognise revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer.

In the circumstances under consideration, customers pay the joining fee and monthly fees to use the facilities provided by the fitness club. The performance obligation is therefore to provide fitness club facilities for customers' use and the joining fee is part of the consideration paid by customers to use the facilities in the future. No performance obligation has been satisfied when the fee is received and, therefore, no revenue should be recognised at that time.

Instead, the joining fee should be recognised as a contract liability. Such consideration would be included in the transaction price and recognised as revenue when (or as) the associated performance obligation(s) are satisfied.

As illustrated in the **example 6.3.6C**, in circumstances where the upfront fee is not for a separate performance obligation and is therefore deferred as a contract liability, an entity will need to consider the appropriate period of time over which to recognise that upfront fee.



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Example 6.3.6C

Accounting for a non-refundable upfront fee

Entity X agrees to provide a customer with services on a monthly basis at a price of CU400 per month, payable at the start of each month. At the outset, Entity X also charges the customer a one-off, non-refundable upfront fee of CU50, for which no separate goods or services are transferred. The customer can cancel the contract at any time without penalty, but will not be entitled to any refund of amounts already paid. Entity X has not committed to any pricing levels for the service in future months. Entity X's average customer life is two years.

The upfront fee does not itself result in the transfer of a good or service to the customer and, thus, is not a performance obligation on its own. Instead, the upfront fee represents an advance payment for Entity X's services and should be deferred and recognised as the future services are provided.

The period over which the upfront fee should be recognised will depend on whether the upfront fee provides the customer with a material right with respect to renewing Entity X's services. In determining this, Entity X should consider both quantitative and qualitative factors (e.g. the renewal price compared to the price a new customer would pay).

If Entity X concludes that the upfront fee does provide a material right, that fee should be recognised over the service period during which the customer is expected to benefit from not having to pay a further upfront fee upon renewal of service. In this example, that is likely to be the estimated customer life of two years.

If Entity X concludes that the upfront fee does not provide the customer with a material right, the entire transaction price of CU450 (comprising the minimum one-month service fee and the upfront fee) should be recognised over the first month as the services are provided, in line with IFRS 15:B49.



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6.3.7 'Stand-ready' obligations

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IFRS 15:26(e) cites the provision of a service of standing ready to provide goods or services (a 'stand-ready' obligation) as an example of a promise in a contract that an entity should assess to determine whether it is a distinct performance obligation (see **6.3.1**).

A stand-ready performance obligation arises when the nature of the entity's promise in a contract is to stand ready to provide goods or services for a period of time rather than to provide the goods or services underlying the obligation. The customer consumes and receives benefit from a stand-ready obligation from the assurance that a service or resource is available to it when and if needed or called upon. Examples of stand-ready obligations include:

- a promise by a software vendor to transfer unspecified future upgrades at its discretion. The vendor promises to make unspecified (i.e. when-and-if-available) software upgrades available to a customer and the entity has no discernible pattern of providing updates. The nature of the vendor's promise is fundamentally one of providing the customer with assurance that any upgrades or updates developed during the period will be made available to the customer;
- a promise to provide when-and-if-available updates to previously licensed intellectual property based on advances in research and development of pharmaceuticals; and
- snow removal from an airport's runways in exchange for a fixed fee for the year. An entity promises to remove snow on an 'as-needed' basis. In this type of arrangement, the entity does not know, and it would likely not be able to reasonably estimate, whether it will snow, as well as how often and how much it will snow. This suggests the nature of the entity's promise is to stand ready to provide these services rather than an actual commitment to provide them.

To identify a stand-ready obligation, an entity should begin by identifying the nature of the promise in the contract on the basis of the particular facts and circumstances. Whether the entity's obligation is to provide a defined good or service, or instead to provide an unknown type or quantity of goods or services, might be a strong indicator as to the nature of the entity's promise in the contract. While in either case the entity might be required to stand ready to deliver the good(s) or service(s) whenever the customer calls for them, or upon the occurrence of a contingent event (e.g. snowfall), the fact that the entity will not know when or how extensively a customer will receive the entity's goods or services during the contract term may be a strong indicator that the entity is standing ready to perform.

Example 9.3.1.1 discusses stand-ready obligations in the context of health club memberships. The example notes that the entity's promise is to provide a service of making the health clubs available, because the extent to which a customer uses the health clubs does not affect the amount of the remaining goods and services to which the customer is entitled. This is consistent with the discussion in IFRS 15:BC160.

See **9.3.2.3** for additional considerations on measuring progress towards the complete satisfaction of a stand-ready obligation that is satisfied over time.



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Section 7. Step 3: Determine the transaction price

7.1 Determination of the transaction price – general

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 those amounts collected on behalf of third parties (e.g. some sales taxes). It may include fixed amounts, variable amounts, or both. Both the terms of the contract and the entity’s customary business practices need to be considered in order to determine the transaction price. [IFRS 15:47]

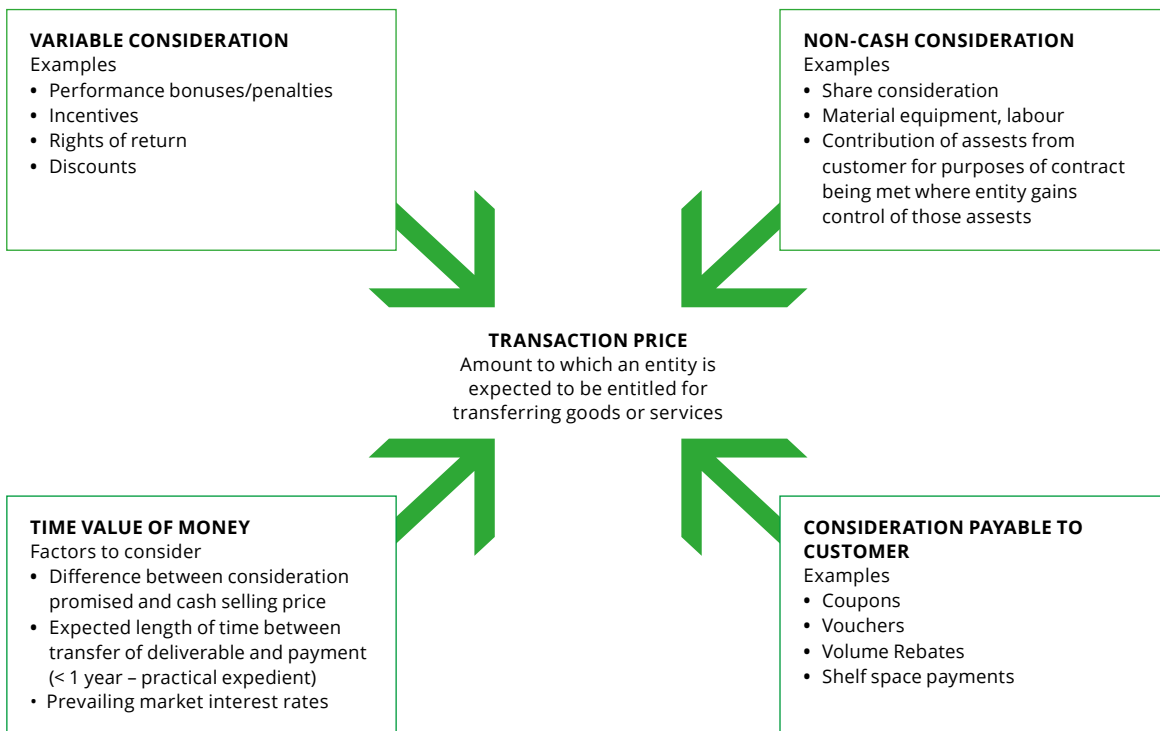
The estimate of the transaction price will be affected by the nature, timing and amount of consideration promised by a customer. In determining the transaction price, the effects of all of the following should be considered:


[IFRS 15:48]

- (a) variable consideration (see 7.2);
- (b) constraining estimates of variable consideration (see 7.2.8);
- (c) the existence of a significant financing component in the contract (see 7.4);
- (d) non-cash consideration (see 7.5); and
- (e) consideration payable to a customer (see 7.6).

The following diagram provides examples of each of these elements

Step 3. Transaction price





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IFRS 15 also introduces a constraint such that for most types of variable consideration, variable consideration should only be included in the transaction price 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 (see **7.2.8**). [IFRS 15:56]

For the purpose of determining the transaction price, it should be assumed that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that there will be no cancellation, renewal or modification. [IFRS 15:49]

IAS 18 includes little guidance on variable consideration and the other topics listed above. In addition, IAS 18 is silent on whether the time value of money should be taken into account when a customer pays in advance.

An entity should only take a customer's credit risk into account when determining the discount rate used to adjust the promised consideration for a significant financing component, if any.

IFRS 15:47 specifies that the transaction price is the amount to which an entity expects to be *entitled* rather than the amount it expects to *collect*. The determination of the amount to which an entity expects to be entitled is not affected by the risk of customer default (i.e. the customer's credit risk). IFRS 15:BC260 and 261 explain that this approach was adopted to enable users of the financial statements to analyse 'gross' revenue (i.e. the amount to which the entity is entitled) separately from the effect of receivables management (or bad debts).

However, when the timing of payments due under the contract provides the customer with a significant benefit of financing, the transaction price is adjusted to reflect the time value of money. IFRS 15:BC239 indicates that, in such circumstances, an entity will take a customer's credit risk into account in determining the appropriate discount rate to apply. As illustrated in **example 7.4.6D**, this rate will affect the amount of revenue recognised for the transfer of goods or services under the contract.

Further, a customer's credit risk is a factor in the determination of whether a contract exists, because one of the criteria for identification of a contract in IFRS 15:9 is that collection of consideration to which the entity is entitled is probable (specifically, IFRS 15:9(e) – see **5.1.1**).

7.2 Estimating variable consideration

7.2.1 Variable consideration

7.2.1.1 Requirement to estimate variable consideration – general


If the consideration includes a variable amount, the entity is required to estimate the amount of consideration to which it will be entitled in exchange for transferring the promised goods or services to the customer. [IFRS 15:50]

7.2.1.2 Identification of variable consideration

Examples of variable consideration include discounts, rebates, refunds, credits, price concessions (see **example 7.3A**), incentives (see **example 7.3B**), performance bonuses and penalties (see **example 7.2.1.2**). Consideration can also vary if entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. Examples include a product sold with a right of return or a fixed amount promised as a performance bonus on achievement of a specified milestone. [IFRS 15:51]



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Example 7.2.1.2**Penalty gives rise to variable consideration**

[IFRS 15:IE102 – IE104, Example 20]

An entity enters into a contract with a customer to build an asset for CU1 million. In addition, the terms of the contract include a penalty of CU100,000 if the construction is not completed within three months of a date specified in the contract.

The entity concludes that the consideration promised in the contract includes a fixed amount of CU900,000 and a variable amount of CU100,000 (arising from the penalty).

The entity estimates the variable consideration in accordance with [IFRS 15:50 to 54] and considers the requirements in [IFRS 15:56 to 58 (see **7.2.8**)] on constraining estimates of variable consideration.

The fact that consideration may vary may be explicitly set out in the contract. However, a contract also includes variable consideration if either of the following circumstances exists:

[IFRS 15:52]

- (a) the customer has a valid expectation arising from the entity's customary business practices, published policies or specific statements that the entity will accept an amount of consideration less than that stated in the contract (i.e. it is expected that the entity will offer a price concession). This offer may be referred to as a discount, rebate, refund or credit in certain jurisdictions or industries; or
- (b) other facts and circumstances indicate that it is the entity's intention to offer a price concession to the customer when entering into the contract with the customer.


7.2.1.3 Selection of method for estimating variable consideration

One of the following methods should be used to estimate the amount of variable consideration, depending on which method better predicts the amount of consideration to which the entity will be entitled:

[IFRS 15:53]

- (a) the **expected value method** – this may be appropriate when the entity has a large number of contracts with similar characteristics and is calculated as the sum of probability-weighted amounts in a range of possible consideration amounts; and
- (b) the **most likely amount** – this may be appropriate when a contract has only two possible outcomes (e.g. the amount received is based on whether a performance bonus is achieved, or not). It is the single most likely amount in a range of possible consideration amounts (i.e. the single most likely outcome of the contract).


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The method an entity uses to estimate variable consideration is not a free choice; an entity should use whichever method will better predict the amount of consideration to which it will become entitled.

When a contract has only two possible outcomes, it will often be appropriate to estimate variable consideration by using a method based on the most likely amount.

When the entity has a large number of contracts with similar characteristics, and the outcome for each contract is independent of the others, the expected value method may better predict the overall outcome for the contracts in aggregate. This will be true even when each individual contract has only two possible outcomes (e.g. a sale with a right of return). This is because an entity will often have better information about the probabilities of various outcomes when there are a large number of similar transactions.

It is important, however, to consider carefully whether the outcome for each contract is truly independent of the others. For example, if the outcome is binary but is determined by the occurrence or non-occurrence of the same event for all contracts (i.e. the variable amount will be received either for all of the contracts or for none of them), the expected value is unlikely to be a good predictor of the overall outcome and the entity may need to use the most likely amount method to estimate the variable consideration in the contracts.

Example 7.2.1.3A

Selection of method for estimating variable consideration

Each year, Entity X's performance is ranked against that of its competitors in a particular jurisdiction. All of Entity X's customer contracts specify that a fixed bonus of CU500 will be due to Entity X if it is ranked in the top quartile. Entity X has approximately 1,000 customer contracts.

Entity X should estimate the variable consideration on the basis of the most likely amount. Although Entity X has a large number of contracts, the outcomes are not independent because they all depend on the same criterion (i.e. the ranking of Entity X against its competitors). The bonus will be payable either in respect of all the contracts or none of them. Therefore, the overall outcome for the contracts in aggregate will be binary and the expected value will not be a good predictor of that overall outcome.

Example 7.2.1.3B

Estimating variable consideration


[IFRS 15:IE105 – IE108, Example 21]

An entity enters into a contract with a customer to build a customised asset. The promise to transfer the asset is a performance obligation that is satisfied over time. The promised consideration is CU2.5 million, but that amount will be reduced or increased depending on the timing of completion of the asset. Specifically, for each day after 31 March 20X7 that the asset is incomplete, the promised consideration is reduced by CU10,000. For each day before 31 March 20X7 that the asset is complete, the promised consideration increases by CU10,000.

In addition, upon completion of the asset, a third party will inspect the asset and assign a rating based on metrics that are defined in the contract. If the asset receives a specified rating, the entity will be entitled to an incentive bonus of CU150,000.



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In determining the transaction price, the entity prepares a separate estimate for each element of variable consideration to which the entity will be entitled using the estimation methods described in [IFRS 15:53]:

- (a) the entity decides to use the expected value method to estimate the variable consideration associated with the daily penalty or incentive (ie CU2.5 million, plus or minus CU10,000 per day). This is because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.
- (b) the entity decides to use the most likely amount to estimate the variable consideration associated with the incentive bonus. This is because there are only two possible outcomes (CU150,000 or CU0) and it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.

The entity considers the requirements in [IFRS 15:56 to 58 (see **7.2.8**)] on constraining estimates of variable consideration to determine whether the entity should include some or all of its estimate of variable consideration in the transaction price.

7.2.1.4 Selected method for estimating variable consideration to be used throughout the contract

One method should be used consistently throughout the contract when estimating the effect of an uncertainty on an amount of variable consideration to which the entity will be entitled. All the information (historical, current and forecast) that is reasonably available to the entity should be considered in assessing the amount of variable consideration, and a reasonable number of possible consideration amounts should be identified. This information would typically be similar to the information that management uses during the bid-and-proposal process and in establishing prices for promised goods or services. [IFRS 15:54]

7.2.1.5 Using more than one method for estimating variable consideration within one contract


When a contract contains multiple elements of variability, an entity is permitted to use more than one method (i.e. the expected value method and the most likely amount method) to estimate the amount of variable consideration to be included in the transaction price. Example 21 of the Illustrative Examples accompanying IFRS 15 (**example 7.2.1.3B**) shows that an entity should prepare a separate estimate for each element of variable consideration in a contract (i.e. for each uncertainty) by using either the expected value method or the most likely amount, whichever method better predicts the amount of consideration to which it will be entitled.

Because IFRS 15:54 (see **7.2.1.4**) requires entities to apply one method consistently to each variable element throughout the contract, it would not be appropriate to switch between the most likely amount and the expected value method for a particular variable element during the life of a contract.

An entity should also consider the guidance in IFRS 15:56 to 58 (see **7.2.8**) on constraining estimates of variable consideration to determine whether it should include some or all of the variable consideration in the transaction price.



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Example 7.2.1.5**Using more than one method to estimate variable consideration within one contract**

Entity X, an information technology service provider, enters into a contract with a customer to develop the customer's website. To induce Entity X to complete the project on a timely basis, and to provide a solution that drives business growth for the customer, the fee receivable by Entity X under the contract includes both fixed and variable consideration which is determined as follows.

- The first element of the fee is based on the performance of the website and is determined by using a sliding scale from CU500,000 to CU1 million. The amount earned is based on a formula that uses a number of metrics (e.g. the number of pages viewed and the number of unique visitors) measured over the two-year period after the website is completed and fully functional.
- The second element of the fee is based on the timely completion of the website and is determined as follows:
 - CU750,000 if the website is completed and fully functional within 90 days of signing the contract; or
 - CU350,000 if the website is completed and fully functional more than 90 days after the contract is signed.

Having considered the guidance in IFRS 15:53 on selecting an appropriate method for estimating the amount of variable consideration, Entity X applies the following methods to each element of variability in the contract:

- the amount of consideration related to the performance of the customer's website is estimated by using the expected value method because Entity X estimates that it could be entitled to a wide range of possible consideration amounts (any amount between CU500,000 and CU1 million); and
- the amount of consideration related to the timely completion of the website is estimated by using the most likely amount method because this element of variable consideration has only two possible outcomes (CU750,000 or CU350,000).

Entity X should continue to use the selected method for each element consistently for the entire duration of the contract.

7.2.1.6 Distinction between the estimation of variable consideration for expected value method based on similar contracts and application of IFRS 15 to a portfolio of contracts




TRG

When an entity has concluded that the expected value method is appropriate to determine variable consideration for a specific contract (see **7.2.1.3**), it may consider evidence from other similar contracts to estimate variable consideration.

As discussed by the TRG, when considering historical experience of similar contracts for the purposes of estimating the expected value of variable consideration for a specific contract, an entity is not applying the portfolio practical expedient (as discussed in **3.4**). Importantly, this means that the restriction on use of the portfolio practical expedient in IFRS 15:4 (i.e. that the entity does not expect the results of applying IFRS 15 to a portfolio of contracts with similar characteristics to be materially different from the results of applying the guidance to the individual contracts in the portfolio) does not apply.



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7.2.1.7 Amount determined using expected value may not be a possible outcome for an individual contract



TRG

In some scenarios, when using a portfolio of data to estimate variable consideration using the expected value method, the amount determined may not represent a possible outcome of an individual contract. However, as discussed by the TRG, the fact that the expected value is not a possible outcome for an individual contract is not a factor that should be considered in selecting the most appropriate method. Therefore, the expected value method can be used when using a portfolio of data to estimate variable consideration even though the amount determined may not represent a possible outcome of an individual contract.

Example 7.2.1.7

Expected value method to estimate variable consideration using a portfolio of data

Entity B enters into a contract for the sale of Product X for CU50 to Customer C. Entity B's policy is to allow unused products to be returned within 30 days for a refund (see [7.2.2](#)). Therefore, the contract includes variable consideration. In addition to the transaction with Customer C, Entity B has a large number of similar sales of Product X (i.e. a homogeneous population of contracts) with the same right of return.


When selecting which method to use to estimate variable consideration in accordance with IFRS 15:53, Entity B concludes that the expected value method will better predict the amount of consideration to which it will become entitled. Using the expected value method, Entity B considers a portfolio of historical data which includes contracts for the sale of Product X. Entity B concludes that this historical data is relevant and consistent with the characteristics of the contract with Customer C. The portfolio of data indicates that 10 out of every 100 products were returned. Using this portfolio of data, Entity B estimates the expected value for the sale of Product X to Customer C to be CU45 (CU50 – (CU50 × 10%)).

The estimate of CU45 is likely to be consistent with the ultimate resolution of the uncertainty with respect to the product return right considering the overall population. This is because, when there is a large number of similar transactions (i.e. a homogeneous population of contracts), the entity's expectation of the amount of consideration to which it will be entitled is better predicted by reference to the probabilities of outcomes exhibited by that portfolio of similar data.

Entity B will separately need to consider whether its estimate of variable consideration should be constrained. In a manner consistent with the logic for measuring variable consideration at expected value, that assessment should consider what amount of variable consideration should be included in the transaction price such that it is highly probable there will not be a significant reversal of revenue on the basis of the homogenous population as a whole (see [7.2.8](#)). Note that, when considering whether the variable consideration should be constrained, the entity is not required to consider the most likely amount to be received, because it has already concluded that the expected value method is appropriate for estimating revenue for this specific contract (see [7.2.8.3](#)).



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7.2.2 Sale with a right of return

In some contracts, an entity transfers control of a product to a customer and also grants the customer the right to return the product for various reasons (e.g. dissatisfaction with the product) and receive a combination of the following:

[IFRS 15:B20]

- (a) a full or partial refund of any consideration paid;
- (b) a credit that can be applied against amounts owed, or that will be owed, to the entity; or
- (c) another product in exchange.

To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), the entity should recognise all of the following:

[IFRS 15:B21]

- (a) an amount of revenue for the products transferred based on the consideration to which the entity expects to be entitled (therefore, revenue should not be recognised for the products expected to be returned);
- (b) a refund liability for the amounts expected to be refunded (see **7.2.3** and **section 13**); and
- (c) an asset, with a corresponding adjustment to cost of sales, for the entity's right to recover products from customers on settling the refund liability.

An entity's promise to stand ready to accept a returned product during the return period is not accounted for as a performance obligation in addition to the obligation to provide a refund. [IFRS 15:B22]


Entities often offer customers the right to return a product within a certain period after its initial sale, provided that the product has not been used or damaged. IFRS 15:B22 states that "[a]n entity's promise to stand ready to accept a returned product during the return period shall not be accounted for as a performance obligation in addition to the obligation to provide a refund" (emphasis added). However, a customer's right to return a product may affect the amount of revenue recognised (the transaction price) because revenue may only be recognised for goods that are not expected to be returned. In accordance with IFRS 15:56, the transaction price should only include amounts for sales subject to return to the extent that it is highly probable that there will not be a significant reversal of cumulative revenue after the uncertainty associated with expected returns is resolved.

The transaction price should be estimated in the same way as any other variable consideration (see **example 7.2.2**) and should reflect the amount to which the entity expects to be entitled, which should be adjusted to exclude amounts expected to be reimbursed or credited to customers, by using either the most likely amount or the expected value method (as discussed at **7.2.1**).

For example, when a retail store has a policy that allows a customer to return a product within 30 days (for any reason), no amount of the transaction price is allocated to the 'service' of standing ready to accept the returned product. Instead, the transaction price is estimated and constrained to the amount for which the entity expects it is highly probable that significant reversal will not occur when the uncertainty associated with expected returns is resolved (see **7.2.8**). An adjustment to revenue will then be recognised when the level of returns is known after 30 days or by updating the estimated transaction price as of any reporting date falling within that period.



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The requirements of IFRS 15 in respect of determining the transaction price, including the guidance on constraining estimates of variable consideration (see **7.2.8**), should be applied to determine the amount of consideration to which the entity expects to be entitled (i.e. excluding the products expected to be returned). When amounts are received (or become receivable) to which an entity does not expect to be entitled, revenue is not recognised when the products are transferred to the customers, but instead a refund liability is recognised. The amount to which the entity expects to be entitled should then be reassessed at the end of each reporting period, and a corresponding change made to the transaction price and, therefore, to the amount of revenue recognised. [IFRS 15:B23]

The refund liability should be updated at the end of each reporting period for changes in expectations about the amount of refunds. Any corresponding adjustments are recognised as revenue (or as reductions of revenue). [IFRS 15:B24]

An asset recognised for an entity's right to recover products from a customer on settling a refund liability should initially be measured by reference to the former carrying amount of the product (e.g. 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, the measurement of the asset should be updated for changes in expectations about products to be returned. The asset should be presented separately from the refund liability. [IFRS 15:B25]

Example 7.2.2

Right of return

[IFRS 15:IE110 – IE115, Example 22]

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 [IFRS 15:4], 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 [IFRS 15:53(a)]) 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 [IFRS 15:56 to 58] 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 [IFRS 15:57] and determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame (ie the 30-day return period). Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (ie CU9,700) will not occur as the uncertainty is resolved (ie over the return period).



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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 [IFRS 15:55] and [IFRS 15:B21], 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).

The requirements of IFRS 15:56 to 58 on constraining estimates of variable consideration are discussed at **7.2.8**.

When a customer exchanges one product for another of the same type, quality, condition and price (e.g. one colour or size for another), this is not considered a return transaction for the purposes of applying IFRS 15. [IFRS 15:B26]

The right of a customer to return a defective product in exchange for a functioning product should be accounted for by applying the guidance on warranties (see **6.3.4**). [IFRS 15:B27]

7.2.3 Refund liabilities

If an entity receives consideration from a customer and expects to refund some or all of that consideration to the customer, a refund liability is recognised. The refund liability is measured at the amount of consideration received (or receivable) to which the entity does not expect to be entitled (i.e. amounts not included in the transaction price). The refund liability is updated at the end of each reporting period for changes in circumstances and corresponding changes made to the transaction price and, therefore, the contract liability. IFRS 15 includes specific guidance when the refund liability relates to a sale with a right of return (see **7.2.2**). [IFRS 15:55]

7.2.4 Cash discounts

Example 7.2.4 Cash discounts


A seller offers a cash discount for immediate or prompt payment (i.e. earlier than required under the normal credit terms). A sale is made for CU100 with the balance due within 90 days. If the customer pays within 30 days, the customer will receive a 10 per cent discount on the total invoice. The seller sells a large volume of similar items on these credit terms (i.e. this transaction is part of a portfolio of similar items). The seller has elected to apply the practical expedient set out in IFRS 15:63 (see **7.4.2**) and, therefore, will not adjust the promised amount of consideration for the effects of a significant financing component.

How should the seller account for this early payment incentive?

IFRS 15 defines 'transaction price' as "the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer". This amount can vary because of discounts, rebates, refunds, credits, incentives, performance bonuses, penalties, price concessions or other similar items.



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In the circumstances described, revenue is CU100 if the discount is not taken and CU90 if the discount is taken. As a result, the amount of consideration to which the entity will be entitled is variable.

Under IFRS 15, if the consideration promised in a contract includes a variable amount, an entity should estimate the amount of variable consideration to which it will be entitled by (1) using either the 'expected value' or the 'most likely amount' method (whichever method the entity expects would better predict the amount of consideration to which it will be entitled), and then (2) considering the effect of the constraint in accordance with IFRS 15:56 to 58 (see **7.2.8**).

Therefore, the seller should recognise revenue when or as the performance obligation is satisfied, net of the amount of cash discount expected to be taken, measured as described in the previous paragraph.

For example, if the discount is taken in 40 per cent of transactions, the expected value will be calculated as follows.

$$(CU100 \times 60\%) + (CU90 \times 40\%) = CU96$$

If the proportion of transactions for which the discount is taken is always close to 40 per cent (i.e. it is within a narrow range around 40 per cent), then it is likely that the estimate of variable consideration will not need to be constrained, and revenue of CU96 will be recognised.

If, however, the proportion of transactions for which the discount is taken varies significantly, it may be necessary to apply the constraint, which will result in the recognition of less revenue. For example, historical records might show that, although the long-term average is 40 per cent, there is great variability from month to month and that the proportion of transactions for which the discount is taken is frequently as high as 70 per cent (but has never been higher than that). In such a scenario, the seller might conclude that only 30 per cent of the variable consideration should be included, because inclusion of a higher amount might result in a significant revenue reversal. In that case, the amount of revenue recognised would be restricted to the following.

$$(CU100 \times 30\%) + (CU90 \times 70\%) = CU93$$

7.2.5 Restocking fees and related cost

TRG

In some industries, customers are not entitled to a full refund if they return a previously purchased product to the seller. In effect, the seller charges a fee for accepting returns, sometimes referred to as a 'restocking' fee. These fees are typically stated within the contract between the seller and the customer.

Restocking fees can serve a number of purposes for the seller – to recover some of the costs it expects to incur in returning the product to saleable inventory (e.g. repackaging or shipping costs), to mitigate a potential reduction in selling price upon resale and/or to discourage customers from returning products.

Restocking fees for expected returns should be incorporated as part of the determination of the transaction price; the entity will need to consider the guidance in IFRS 15:50 to 54 regarding estimation of variable consideration (see **7.2.1**).

In accordance with IFRS 15:B25, the costs expected to be incurred when the products are returned should be recognised at the date when control is transferred to the customer, as a reduction of the carrying amount of the asset expected to be recovered.



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Example 7.2.5**Restocking fees and related costs**

Entity X enters into a contract with Customer Y to sell 10 widgets for CU100 each for cash. The cost of each widget to Entity X is CU75. Customer Y has the right to return widgets, but will be charged a restocking fee of 10 per cent (i.e. CU10 per widget). Entity X expects to incur costs of CU5 per widget to ship and repackage each item returned before it can be resold.

Entity X concludes that, because Customer Y has a right of return, the consideration promised under the contract includes a variable amount. Entity X uses the expected value method for estimating the variable consideration and estimates that 10 per cent of widgets will be returned and that it is highly probable that returns will not exceed 10 per cent. Entity X also expects that the returned widgets can be resold at a profit.

When control of the 10 widgets is transferred to the customer, Entity X recognises revenue of CU900 for nine widgets sold (CU100 × 9). In respect of the widget expected to be returned, Entity X includes in the transaction price the restocking fee expected to be received of CU10 (CU100 × 10%) and a refund liability of CU90 (CU100 transaction price less CU10 restocking fee).

		CU	CU
Dr	Cash	1,000	
Cr	Revenue		910
Cr	Refund liability		90

On the cost side:

- in accordance with IFRS 15:B25, Entity X recognises an asset for its right to recover the widget from Customer Y on settlement of the refund liability. The asset is measured at the former carrying amount of the inventory item as reduced by the expected costs to recover the product. Entity X therefore recognises an asset of CU70 (CU75 cost of inventory less CU5 shipping/repackaging costs expected to be incurred); and
- cost of sales is CU680, being the aggregate of (1) the cost of items sold and not expected to be returned of CU675 (9 widgets × CU75), and (2) the anticipated shipping/repackaging costs of CU5.


		CU	CU
Dr	Products expected to be returned (asset)	70	
Dr	Cost of sales	680	
Cr	Inventories		750

When the widget is returned by Customer Y, CU90 is refunded. The widget is returned to inventory. Entity X incurs the shipping/repackaging costs and includes that cost in the inventory amount as follows.

		CU	CU
Dr	Refund liability	90	
Cr	Cash (refund paid to customer)		90
Dr	Inventories	75	
Cr	Products expected to be returned		70
Cr	Cash (payment of shipping/repackaging costs)		5



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7.2.6 Contracts that include consideration in a foreign currency

Despite the broad definition of variable consideration in IFRS 15 (see **7.2.1**), consideration that is fixed in a foreign currency should not be considered variable consideration. This is because the amount of consideration promised in the contract does not vary; instead, that fixed amount of consideration is retranslated to a variable amount of the entity's functional currency.

In particular, therefore, an entity is not required to consider whether potential future adverse movements in the exchange rate could result in a requirement to limit the amount of revenue recognised in accordance with IFRS 15:56 (see **7.2.8**). Instead, the principles of IAS 21 *The Effects of Changes in Foreign Exchange Rates* should be applied.

7.2.7 Reassessment of variable consideration

The estimated transaction price is updated at the end of each reporting period (including updating the assessment of whether an estimate of variable consideration should be constrained – see **7.2.8**) to represent the circumstances present at the end of the reporting period and any changes in circumstances during the reporting period. IFRS 15 specifies how changes in the estimated transaction price should be recognised (see **8.5**). [IFRS 15:59]

7.2.8 Constraining estimates of variable consideration

7.2.8.1 Constraining estimates of variable consideration – general

IFRS 15 includes separate requirements in relation to the recognition of revenue for a sales- or usage-based royalty promised in exchange for a licence of intellectual property. These are discussed at **11.2**.

For all other types of variable consideration, variable consideration should only be included in the transaction price 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. [IFRS 15:56]


An entity should consider both the likelihood and the magnitude of the revenue reversal when 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. Factors that may increase the likelihood or the magnitude of a revenue reversal include the following:

[IFRS 15:57]

- (a) the amount of consideration is highly susceptible to factors outside the entity's influence. For example volatility in a market, the judgement or actions of third parties, weather conditions or 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 experience (or other evidence) that the entity has 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; and
- (e) there are a large number and broad range of possible consideration amounts within the contract.



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7.2.8.2 Constraint on variable consideration assessed at the contract level

TRG

When determining the amount of variable consideration to include in the transaction price, the likelihood and significance of a potential revenue reversal should be assessed at the contract level and not at the performance obligation level.

As described in **section 4**, the transaction price for the contract is determined in Step 3 of the revenue model and, consequently, the unit of account for determining the transaction price is the contract level. The revenue constraint forms part of the determination of transaction price; accordingly, the likelihood and significance of a potential revenue reversal should be assessed at the contract level.

Example 7.2.8.2

Constraint on variable consideration assessed at the contract level

An entity enters into a contract with a customer to provide equipment and consulting services. The contract price for the equipment is CU10 million. The consulting services are priced at a fee of CU100,000, of which CU55,000 is fixed and CU45,000 is contingent on the customer reducing its manufacturing costs by 5 per cent over a one-year period.

It is also concluded that:

- the equipment and the consulting services are separate performance obligations; and
- the stand-alone selling prices of the equipment and consulting services are CU10 million and CU100,000 respectively.

The entity believes there is a 60 per cent likelihood that it will be entitled to the performance-based element of the consulting services fee. As a result, using the most likely amount approach described in IFRS 15:53(b) (see **7.2.1.3**), the entity estimates the amount of the variable consideration as CU45,000. The transaction price of the contract before considering the constraint is, therefore, CU10.1 million.

The entity then considers the constraint to determine if it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. The entity considers both the likelihood and magnitude of a revenue reversal at the contract level.

There is a 40 per cent chance that the contingent consulting services fee of CU45,000 will not be receivable. Accordingly, the entity concludes that it is not highly probable that it will be entitled to the variable consideration. However, the significance of the potential revenue reversal of CU45,000 is evaluated in the context of the contract as a whole (CU45,000 as a proportion of the transaction price, CU10.1 million, i.e. 0.45%) and not the performance obligation (CU45,000 as a proportion of the amount assigned to the performance obligation, CU100,000, i.e. 45%). Therefore, the entity concludes that all of the variable consideration should be included in the transaction price, because it is highly probable that no *significant* revenue reversal will occur.



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7.2.8.3 Interaction between expected value method and variable consideration constraint

TRG When an entity has concluded that the expected value method is appropriate to determine variable consideration (see 7.2.1.3), application of the constraint in IFRS 15:56 is performed based on the expected value method. Therefore, an entity is not required to switch from an expected value to a most likely amount method for the purposes of applying the constraint. As a result, if the constraint is applied, the constrained transaction price does not need to be a possible outcome for an individual contract.

Example 7.2.8.3


Interaction between expected value method and the variable consideration constraint

Entity X provides a standard service to a large number of customers. The contracts with the customers include standard terms and conditions and pricing is based on a fixed fee in addition to a performance bonus for which the amount payable depends on how quickly the service is completed. Entity X has concluded that, in accordance with IFRS 15:53, the expected value method is appropriate for the purposes of calculating variable consideration. On the basis of the entity’s historical experience of other similar contracts, the probabilities of achieving the performance bonus are as follows:

Performance bonus	Probability
CUnil	10%
CU75,000	50%
CU150,000	40%

Using the expected value method, Entity X calculates the variable consideration to be CU97,500 $([CUnil \times 10 \text{ per cent}] + [CU75,000 \times 50 \text{ per cent}] + [CU150,000 \times 40 \text{ per cent}])$. Entity X is then required to consider whether it is highly probable that recognition of revenue of that amount will not result in a significant reversal of cumulative revenue when the uncertainty in the contract is resolved at a future date. However, this does not mean that Entity X should constrain the variable consideration to an amount that it is highly probable will actually be received on an individual contract basis (i.e. CU75,000). Instead, consistent with its logic for measuring variable consideration on an expected value basis, Entity X should consider what amount of variable consideration should be included in the transaction price such that it is highly probable there will not be a significant reversal of revenue based on the population as a whole.





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7.3 Variable consideration – further examples

Example 7.3A

Price concessions

[IFRS 15:IE116 – IE123, Example 23]

An entity enters into a contract with a customer, a distributor, on 1 December 20X7. The entity transfers 1,000 products at contract inception for a price stated in the contract of CU100 per product (total consideration is CU100,000). Payment from the customer is due when the customer sells the products to the end customers. The entity's customer generally sells the products within 90 days of obtaining them. Control of the products transfers to the customer on 1 December 20X7.

On the basis of its past practices and to maintain its relationship with the customer, the entity anticipates granting a price concession to its customer because this will enable the customer to discount the product and thereby move the product through the distribution chain. Consequently, the consideration in the contract is variable.

Case A – Estimate of variable consideration is not constrained


The entity has significant experience selling this and similar products. The observable data indicate that historically the entity grants a price concession of approximately 20 per cent of the sales price for these products. Current market information suggests that a 20 per cent reduction in price will be sufficient to move the products through the distribution chain. The entity has not granted a price concession significantly greater than 20 per cent in many years.

To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see [IFRS 15:53(a)]) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates the transaction price to be CU80,000 (CU80 × 1,000 products).

The entity also considers the requirements in [IFRS 15:56 to 58] on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of CU80,000 can be included in the transaction price. The entity considers the factors in [IFRS 15:57] and determines that it has significant previous experience with this product and current market information that supports its estimate. In addition, despite some uncertainty resulting from factors outside its influence, based on its current market estimates, the entity expects the price to be resolved within a short time frame. Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (ie CU80,000) will not occur when the uncertainty is resolved (ie when the total amount of price concessions is determined). Consequently, the entity recognises CU80,000 as revenue when the products are transferred on 1 December 20X7.



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Case B – Estimate of variable consideration is constrained

The entity has experience selling similar products. However, the entity's products have a high risk of obsolescence and the entity is experiencing high volatility in the pricing of its products. The observable data indicate that historically the entity grants a broad range of price concessions ranging from 20–60 per cent of the sales price for similar products. Current market information also suggests that a 15–50 per cent reduction in price may be necessary to move the products through the distribution chain.


To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see [IFRS 15:53(a)]) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that a discount of 40 per cent will be provided and, therefore, the estimate of the variable consideration is CU60,000 (CU60 × 1,000 products).

The entity also considers the requirements in [IFRS 15:56 to 58] on constraining estimates of variable consideration to determine whether some or all of the estimated amount of variable consideration of CU60,000 can be included in the transaction price. The entity considers the factors in [IFRS 15:57] and observes that the amount of consideration is highly susceptible to factors outside the entity's influence (ie risk of obsolescence) and it is likely that the entity may be required to provide a broad range of price concessions to move the products through the distribution chain. Consequently, the entity cannot include its estimate of CU60,000 (ie a discount of 40 per cent) in the transaction price because it cannot conclude that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. Although the entity's historical price concessions have ranged from 20–60 per cent, market information currently suggests that a price concession of 15–50 per cent will be necessary. The entity's actual results have been consistent with then-current market information in previous, similar transactions. Consequently, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised will not occur if the entity includes CU50,000 in the transaction price (CU100 sales price and a 50 per cent price concession) and therefore, recognises revenue at that amount. Therefore, the entity recognises revenue of CU50,000 when the products are transferred and reassesses the estimates of the transaction price at each reporting date until the uncertainty is resolved in accordance with [IFRS 15:59].

Note that in **example 7.3A**, it is assumed as part of the fact pattern that control of the products transfers to the distributor at contract inception. However, the fact that the distributor only becomes obliged to pay for the products when it sells them to end customers is an indication that this might be a consignment arrangement. Consignment arrangements are discussed at **9.4.4**.



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Example 7.3B**Volume discount incentive**

[IFRS 15:IE124 – IE128, Example 24]

An entity enters into a contract with a customer on 1 January 20X8 to sell Product A for CU100 per unit. If the customer purchases more than 1,000 units of Product A in a calendar year, the contract specifies that the price per unit is retrospectively reduced to CU90 per unit. Consequently, the consideration in the contract is variable.

For the first quarter ended 31 March 20X8, the entity sells 75 units of Product A to the customer. The entity estimates that the customer's purchases will not exceed the 1,000-unit threshold required for the volume discount in the calendar year.

The entity considers the requirements in [IFRS 15:56 to 58] on constraining estimates of variable consideration, including the factors in [IFRS 15:57]. The entity determines that it has significant experience with this product and with the purchasing pattern of the entity. Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (ie CU100 per unit) will not occur when the uncertainty is resolved (ie when the total amount of purchases is known). Consequently, the entity recognises revenue of CU7,500 (75 units × CU100 per unit) for the quarter ended 31 March 20X8.

In May 20X8, the entity's customer acquires another company and in the second quarter ended 30 June 20X8 the entity sells an additional 500 units of Product A to the customer. In the light of the new fact, the entity estimates that the customer's purchases will exceed the 1,000-unit threshold for the calendar year and therefore it will be required to retrospectively reduce the price per unit to CU90.

Consequently, the entity recognises revenue of CU44,250 for the quarter ended 30 June 20X8. That amount is calculated from CU45,000 for the sale of 500 units (500 units × CU90 per unit) less the change in transaction price of CU750 (75 units × CU10 price reduction) for the reduction of revenue relating to units sold for the quarter ended 31 March 20X8 (see [IFRS 15:87 and 88]).


Example 7.3C**Management fees subject to the constraint**

[IFRS 15:IE129 – IE133, Example 25]

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 [IFRS 15:22(b)], 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).


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At contract inception, the entity considers the requirements in [IFRS 15:50 to 54] on estimating variable consideration and the requirements in [IFRS 15:56 to 58] on constraining estimates of variable consideration, including the factors in [IFRS 15:57]. 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 [IFRS 15:84(b) and 85 (see 8.5)]. 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 [IFRS 15:73]. Consequently, the entity recognises CU2 million as revenue for the quarter ended 31 March 20X8.

Example 7.3D

Accounting for trail commissions (insurance agent or broker)

Entity A, an insurance agent, is engaged by Entity B, an insurer, to act as Entity B's agent in signing up members of the general public to insurance contracts with Entity B.

Entity A is compensated by Entity B on a 'trail commission' basis, as follows:

- an initial commission of CU100 for each consumer Entity A signs up to an insurance contract with Entity B; and
- an annual commission of CU50 in future years every time a consumer renews its insurance policy with Entity B.


Entity A signs up many consumers on behalf of Entity B such that Entity A has a large pool of homogenous transactions with historical information about consumer renewal patterns for insurance policies.

Entity A does not have any ongoing obligation to provide additional services to Entity B or to consumers after the initial sale of insurance. In particular, Entity A is not involved when a consumer's existing insurance policy is renewed.

The consideration promised in this arrangement includes both fixed and variable amounts. The initial commission of CU100 due to Entity A upon signing up a customer is fixed consideration and is included in the transaction price. In addition, the transaction price includes variable consideration in the form of potential additional commissions due (CU50 per each additional year) if and when the consumer subsequently renews the insurance policy. In accordance with the guidance in IFRS 15:50 to 54, Entity A estimates the variable consideration (see 7.2). Since Entity A has a large pool of homogeneous contracts on which to base its estimate, the expected value approach is used.



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Entity A considers evidence from other, similar contracts to develop an estimate of variable consideration under the expected value method since there is a population of data with which Entity A can make such an estimate.

Entity A also considers the guidance in IFRS 15:60 to 65 to assess whether the contract includes a significant financing component, meaning that the annual commissions it expects to receive should be adjusted for the effects of the time value of money (see 7.4).

Finally, Entity A considers the guidance in IFRS 15:56 to 59 to constrain the amount of variable consideration that should be included in the transaction price (see 7.2.8.1). Entity A considers both the likelihood and the magnitude of the revenue reversal when 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. If Entity A does need to constrain the amount of revenue recognised, it should restrict the revenue it recognises to an amount that is highly probable not to be subject to significant reversal.

Example 7.3E

Accounting for trail commissions (investment manager)

Investment Manager (IM) engages Financial Adviser X (Adviser X) to sell to the general public units in funds managed by IM. IM compensates Adviser X on a 'trail commission' basis, which means that Adviser X does not receive any cash on completion of the sale of units but instead receives a quarterly fee calculated as 1.25 per cent of the management fee that IM earns from the investors introduced by Adviser X during the period that the investors remain invested in the fund. IM's management fee is calculated as a percentage of the growth in the net asset value (NAV) of the funds and is therefore highly susceptible to factors outside Adviser X's influence (e.g. volatility in the market and the length of time that particular investors remain with the funds (i.e. 'churn rates')). The quarterly fees paid to Adviser X by IM are not subject to clawback.

When one of the investors introduced by Adviser X redeems its units and divests from the funds, IM ceases the payment of commission to Adviser X in respect of that investor. Adviser X does not provide any additional services to IM or to the investors subsequent to the sale of the units.

Because the trail commission relates to the selling of units and no additional services are to be provided, Adviser X has satisfied its performance obligation once the units are sold. Adviser X needs to determine the amount of consideration associated with selling units.


Because the total amount of trail commission in this example is determined on the basis of (1) the growth in the funds' NAV, and (2) churn rates, the consideration is variable. Adviser X considers the guidance in IFRS 15:56 to 59 (see 7.2.8.1), which has the effect of constraining the amount of variable consideration that should be included in the transaction price. In considering the factors in IFRS 15:57 that could increase the likelihood or magnitude of a revenue reversal, Adviser X applies judgement and performs this evaluation, taking into account all relevant facts and circumstances. The consideration is highly susceptible to factors outside the entity's influence (e.g. volatility in the market, churn rates), and a subsequent change in the estimate of the amount of trail commission to which Adviser X expects to be entitled may result in a significant downward adjustment to the amount of revenue if not constrained.

In accordance with IFRS 15:56, Adviser X evaluates the nature of the underlying assets and any restrictions on investor withdrawals to determine whether there is some lower amount of consideration for which it is highly probable that a significant revenue reversal will not occur once the uncertainty associated with the variable consideration is resolved. On the basis of its assessment of the funds, Adviser X concludes that no such amount meets the threshold to be included in the transaction price at the time of sale and does not recognise any revenue upon selling the units.

Instead, Adviser X recognises revenue when the uncertainty is resolved (i.e. at the end of each period for which IM charges management fees because only at that point will the effect of investor churn and fund performance be known). In this example, IM charges management fees on a quarterly basis, so Adviser X will be able to recognise revenue at the end of each quarter when the uncertainty associated with the growth in the fund's NAV and the amount of investor churn is resolved.



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7.4 Significant financing component

7.4.1 Significant financing component – meaning

In determining the transaction price, a promised amount of consideration is adjusted for the effects of the time value of money if the timing of payments agreed to by the parties to the contract provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In such circumstances, the contract contains a significant financing component which may exist irrespective of whether the promise of financing is stated explicitly in the contract or implied by the payment terms agreed to by the parties to the contract. [IFRS 15:60]

7.4.2 Practical expedient – no adjustment required for financing component for timing differences of one year or less

When the entity expects, at contract inception, that the period between the entity transferring a good or service and the customer paying for it will be one year or less, IFRS 15 does not require adjustment of the consideration for the effects of a significant financing component. [IFRS 15:63] If this practical expedient is taken, it should be applied consistently to contracts with similar characteristics and in similar circumstances. [IFRS 15:3]

Example 7.4.2

Requirement to discount trade receivables

Entity A, a retailer, offers interest-free financing to its customers. Depending on the type of product purchased, the financing arrangement gives the customer interest-free financing for a period of 12, 15 or 18 months. The customer pays equal monthly instalments from the date of purchase over the financing period. This is common industry practice in the country where Entity A is located, and other retailers offer similar financing arrangements. No recent cash transactions are available from which Entity A can make a reliable estimate of the cash sales price. On the basis of prevailing interest rates in the relevant market, Entity A estimates that the customer would be able to borrow from other sources at an interest rate of 18 per cent.

In accordance with IFRS 15:61(b) (see 7.4.3), Entity A believes that as a result of the combination of (1) the length of time between the transfer of goods and payment, and (2) the high interest rates at which the customer can obtain financing, the arrangement contains a significant financing component.

Is Entity A required to adjust the transaction prices in all its interest-free financing sale arrangements to reflect the effects of the time value of money?


In accordance with IFRS 15:60, entities are required to adjust the promised amount of consideration even when a significant financing component is not explicitly identified in the contract. However, IFRS 15:63 provides a practical expedient for contracts with a significant financing component when the period between the transfer of goods and the customer's payment is, at contract inception, expected to be one year or less.

Consequently, in the circumstances described, Entity A is required to adjust the sales price for all arrangements other than those with a contractual period of 12 months or less. For arrangements with a contractual period of 12 months or less, Entity A is permitted to adjust the sales price when it identifies a significant financing component, which it may wish to do to align with its other contracts; however, it is not required to do so.

If Entity A takes advantage of the practical expedient under IFRS 15:63, it is required to do so consistently in similar circumstances for all contracts with similar characteristics.



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7.4.3 Identification of a significant financing component

7.4.3.1 Relevant factors for the identification of a significant financing component

The objective of the requirement in IFRS 15:60 is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid if the customer had paid cash for the goods or services when (or as) they transfer to the customer (i.e. the cash selling price). All relevant facts and circumstances should be considered in assessing (1) whether a contract contains a financing component, and (2) whether that financing component is significant to the contract. Relevant considerations include the following:

[IFRS 15:61]

- (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:
 - (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.


TRG

In some situations, the implied interest rate in an arrangement is zero (i.e. interest free-financing) such that the consideration to be received at a future date is equal to the cash selling price (i.e. the amount that would be received from a customer who chooses to pay for the goods or services in cash when (or as) they are delivered).

In such circumstances, it should not automatically be assumed that the contract does not contain a significant financing component. A difference between the amount of promised consideration and the cash selling price is only one of the indicators that an entity should consider in determining whether there is a significant financing component. The fact that an entity provides what appears to be zero-interest finance rate does not necessarily mean that the cash selling price is the same as the price that would have been paid by another customer who has opted to pay over time. Accordingly, an entity may need to use judgement when determining a cash selling price for a customer who pays over time.



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7.4.3.2 Determining at what level the 'significance' of a financing component should be assessed

IFRS 15:61 specifically requires an entity to 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*. Consequently, the significance of a financing component should be assessed in the context of the individual contract rather than, for example, for a portfolio of similar contracts or at a performance obligation level.

The basis of this requirement is explained in IFRS 15:BC234, which states as follows.

“During their redeliberations, the boards clarified that an entity should consider only the *significance* of a financing component at a contract level rather than consider whether the financing is *material* at a portfolio level. The boards decided that it would have been unduly burdensome to require an entity to account for a financing component if the effects of the financing component were not material to the individual contract, but the combined effects for a portfolio of similar contracts were material to the entity as a whole.”

As a consequence, some financing components will not be identified as significant – and, therefore, the promised amount of consideration will not be adjusted – even though they might be material in aggregate for a portfolio of similar contracts.

Although a financing component can only be quantified by considering individual performance obligations, the significance of a financing component is not assessed at the performance obligation level. To illustrate, an entity may typically sell Product X, for which revenue is recognised at a point in time, on extended credit terms such that, when Product X is sold by itself, the contract contains a significant financing component. The entity may also sell Product X and Product Y together in a bundled contract, requiring the customer to pay for Product Y in full at the time control is transferred but granting the same extended credit terms for Product X. If the value of Product Y is much greater than the value of Product X, any financing component in respect of Product X may be too small to be assessed as significant in the context of the larger bundled contract. Therefore, in such circumstances, the entity would:

- adjust the promised consideration for a significant financing component when Product X is sold by itself; but
- not adjust the promised consideration for a significant financing component when Product X is sold together with Product Y in a single contract.


TRG

As discussed by the TRG, in some circumstances it may be reasonable to attribute a significant financing component to one or more, but not all, of the performance obligations in the contract. As a practical matter, when an entity considers the basis for such attribution, it may be appropriate for the entity to analogise to (1) the guidance on allocating a discount (see **8.3**), or (2) the guidance on allocating variable consideration (see **8.5**).

An entity that is considering the possibility of attributing a significant financing component to one or more, but not all, of the performance obligations in a contract will need to use judgement in determining whether such an approach is reasonable in the particular circumstances of that contract. In particular, in accordance with IFRS 15:85(b), it will be important to ensure that attributing the significant financing component to one or more, but not all, of the performance obligations is consistent with IFRS 15's allocation objective (see **8.1**) when considering all of the performance obligations and payment terms in the contract.



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7.4.3.3 Financing components that are not significant



TRG

While there is no requirement for an entity to adjust for the time value of money when a financing component is not considered to be significant in the context of the contract, there is nothing to preclude an entity from doing so.

7.4.4 Circumstances that do not give rise to a significant financing component

A contract with a customer does not include a significant financing component if any of the following factors exist:

[IFRS 15:62]

- (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 (e.g. if the consideration is a sales-based royalty); or
- (c) the difference between the promised consideration and the cash selling price of the good or service (as described in IFRS 15:61 – see **7.4.3.1**) 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 (see **examples 7.4.4A** and **7.4.4B**). For example, the payment terms might provide the entity or the customer with protection from the other party failing adequately to complete some or all of its obligations under the contract.




TRG

There is no presumption in IFRS 15 that there is a significant financing component when there is a difference in timing between when goods or services are transferred and when the promised consideration is paid. IFRS 15:62(c) states that a contract would not have a significant financing component if the difference between the promised consideration and the cash selling price of the goods or services “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”.

An entity should use judgement to determine (1) whether the payment terms are intended to provide financing or are for another valid reason, and (2) whether the difference between the promised consideration and the cash selling price of the goods or services is proportional to that reason.



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Example 7.4.4A**Withheld payments on a long-term contract**

[IFRS 15:IE141 & IE142, Example 27]

An entity enters into a contract for the construction of a building that includes scheduled milestone payments for the performance by the entity throughout the contract term of three years. The performance obligation will be satisfied over time and the milestone payments are scheduled to coincide with the entity's expected performance. The contract provides that a specified percentage of each milestone payment is to be withheld (ie retained) by the customer throughout the arrangement and paid to the entity only when the building is complete.

The entity concludes that the contract does not include a significant financing component. The milestone payments coincide with the entity's performance and the contract requires amounts to be retained for reasons other than the provision of finance in accordance with [IFRS 15:62(c)]. The withholding of a specified percentage of each milestone payment is intended to protect the customer from the contractor failing to adequately complete its obligations under the contract.

Example 7.4.4B**Advance payment**


[IFRS 15:IE152 – IE154, Example 30]

An entity, a technology product manufacturer, enters into a contract with a customer to provide global telephone technology support and repair coverage for three years along with its technology product. The customer purchases this support service at the time of buying the product. Consideration for the service is an additional CU300. Customers electing to buy this service must pay for it upfront (ie a monthly payment option is not available).

To determine whether there is a significant financing component in the contract, the entity considers the nature of the service being offered and the purpose of the payment terms. The entity charges a single upfront amount, not with the primary purpose of obtaining financing from the customer but, instead, to maximise profitability, taking into consideration the risks associated with providing the service. Specifically, if customers could pay monthly, they would be less likely to renew and the population of customers that continue to use the support service in the later years may become smaller and less diverse over time (ie customers that choose to renew historically are those that make greater use of the service, thereby increasing the entity's costs). In addition, customers tend to use services more if they pay monthly rather than making an upfront payment. Finally, the entity would incur higher administration costs such as the costs related to administering renewals and collection of monthly payments.

In assessing the requirements in [IFRS 15:62(c)], the entity determines that the payment terms were structured primarily for reasons other than the provision of finance to the entity. The entity charges a single upfront amount for the services because other payment terms (such as a monthly payment plan) would affect the nature of the risks assumed by the entity to provide the service and may make it uneconomical to provide the service. As a result of its analysis, the entity concludes that there is not a significant financing component.


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7.4.5 Measuring the amount of revenue when a transaction includes a significant financing component

When a significant financing component is identified, IFRS 15:60 requires “an entity to adjust the promised amount of consideration for the effects of the time value of money”.

IFRS 15:61 states as follows.

“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).”

However, IFRS 15:64 (see **7.4.6**) states, in part, as follows.

“To meet the objective in [IFRS 15:61] when adjusting the promised amount of consideration for a significant financing component, an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract, as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract.”

IFRS 15:64 also states that “[a]n entity *may* be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer” (emphasis added).

Accordingly, although the objective described in IFRS 15:61 is to determine the ‘cash selling price’, IFRS 15:64 makes clear that such price is required to be consistent with the price that would be determined by using an appropriate discount rate to discount the promised consideration.

Therefore, in practice, the entity may make an initial estimate of the amount of revenue either:


- (1) by determining the appropriate discount rate (see **7.4.6**) and using that rate to discount the promised amount of consideration (see **example 7.4.6F**); or
- (2) by estimating the cash selling price directly – but only if the discount rate thereby implied is consistent with a rate that would be reflected in a separate financing transaction between the entity and its customer (see **example 7.4.6G**).

Irrespective of the approach it adopts, the entity may need to perform further analysis if the amounts estimated appear unreasonable or inconsistent with other evidence relating to the transaction.

- If the entity estimates revenue by discounting the promised consideration, it may be required to perform further analysis if that estimate appears unreasonable and inconsistent with other evidence of the cash selling price. For example, if the amount of revenue estimated appears significantly higher than the normal cash selling price, this may indicate that the discount rate has not been determined on an appropriate basis.
- If the entity estimates revenue by estimating the cash selling price directly, it may be required to perform further analysis if the resulting discount rate appears unreasonable and inconsistent with other evidence of the rate that would be reflected in a separate financing transaction between the entity and its customer. If the rate is clearly significantly lower or higher than would be reflected in a separate financing transaction, it will not be appropriate to measure revenue by reference to the cash selling price; instead, the entity should estimate revenue by discounting the promised consideration at an appropriately estimated discount rate.



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7.4.6 Determining the discount rate

To meet the objective in IFRS 15:61 (see **7.4.3.1**), the discount rate used should reflect that which would be used in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the party receiving financing in the contract, as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract. This may be determined by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer. After contract inception, the discount rate is not updated for changes in interest rates or other circumstances (such as a change in the assessment of the customer's credit risk). [IFRS 15:64]

Example 7.4.6A

Determining the discount rate

[IFRS 15:IE143 – IE147, Example 28]

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 [IFRS 15:64], 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.

For entities that have not yet adopted IFRS 9, the reference in **example 7.4.6A** would instead be to IAS 39 *Financial Instruments: Recognition and Measurement*.



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Example 7.4.6B**Determining the appropriate discount rate when accounting for a significant financing component in an individual contract**

Entity X sells industrial products to customers under contracts for which payment is due 24 months after delivery. Entity X determines that the contract terms give customers a significant benefit of financing the purchase of the industrial products. Accordingly, in accordance with IFRS 15:60, Entity X adjusts the transaction price and corresponding amount of revenue recognised for the sale of the goods to take into account the effect of the time value of money. Entity X does not intend to apply a portfolio approach in determining the effects of this financing benefit.

How might Entity X determine the appropriate discount rate to apply to the payments to be received from its customers?

Under IFRS 15:64, Entity X should use the discount rate that would be reflected in a separate financing transaction between itself and its customer at contract inception. The way in which Entity X identifies this rate will depend on the type of information to which it has access for individual customers.


In determining this discount rate, Entity X may find it useful to consider the following:

- the normal rate at which Entity X would provide secured or unsecured lending (whichever is appropriate) to this customer (e.g. any interest rate that would be normal for Entity X to offer to this customer);
- the normal rate at which other entities would provide secured or unsecured lending (whichever is appropriate) to this customer (e.g. the rate charged to the customer for bank loans). Note, however, that IFRS 15:64 requires a rate specific to a financing transaction between the entity and its customer;
- the cash sales price offered for this product to customers with similar demographic characteristics;
- any interest rate explicitly stated in the contract with the customer. However, this will not always be an appropriate rate (e.g. when a customer is offered interest-free credit or when a low interest rate is used to incentivise the customer);
- the level of certainty regarding the customer's credit characteristics that Entity X obtains as a result of its due diligence processes (e.g. obtaining credit ratings); and
- historical evidence of any defaults or slow payment by this customer.

Appropriate adjustments should be made to rates associated with any of these factors when they are not directly comparable to those of the transaction being considered.



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Example 7.4.6C**Determining the appropriate discount rate when accounting for a significant financing component in a contract using a portfolio approach**

Entity X is a retail business that enters into a large number of similar contracts in which it sells products to individual customers and payment is due 24 months after delivery.

Entity X determines that the contract terms give customers a significant benefit of financing the purchase of the products. Accordingly, under IFRS 15:60, Entity X adjusts the transaction price and corresponding amount of revenue recognised for the sale of the goods to take into account the effect of the time value of money.

Entity X reasonably expects that the financial statement effects of calculating a discount rate that applies to the portfolio of contracts would not differ materially from the discount rates that would apply to individual contracts. Therefore, in accordance with IFRS 15:4, it intends to apply such a portfolio approach (see 3.4).

How might Entity X determine the appropriate discount rate to apply to a portfolio of contracts?

Under IFRS 15:64, Entity X should use the discount rate that would be reflected in a separate financing transaction between itself and its customers at contract inception.

Factors that may be relevant to determining such a rate are discussed in **example 7.4.6B**. However, in applying a portfolio approach, Entity X will need to consider the demographic characteristics of the customers as a group to estimate the discount rate on a portfolio basis. If the demographic characteristics of customers within this group vary significantly, it may not be appropriate to treat them as a single portfolio and it may be necessary to further subdivide the customer group when making this determination.

Example 7.4.6D**Advance payment and assessment of discount rate**

[IFRS 15:IE148 – IE151, Example 29]


An entity enters into a contract with a customer to sell an asset. Control of the asset will transfer to the customer in two years (ie the performance obligation will be satisfied at a point in time). The contract includes two alternative payment options: payment of CU5,000 in two years when the customer obtains control of the asset or payment of CU4,000 when the contract is signed. The customer elects to pay CU4,000 when the contract is signed.

The entity concludes that the contract contains a significant financing component because of the length of time between when the customer pays for the asset and when the entity transfers the asset to the customer, as well as the prevailing interest rates in the market.

The interest rate implicit in the transaction is 11.8 per cent, which is the interest rate necessary to make the two alternative payment options economically equivalent. However, the entity determines that, in accordance with [IFRS 15:64], the rate that should be used in adjusting the promised consideration is six per cent, which is the entity's incremental borrowing rate.



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The following journal entries illustrate how the entity would account for the significant financing component:

(a) recognise a contract liability for the CU4,000 payment received at contract inception:

Cash	CU4,000	
Contract liability		CU4,000

(b) during the two years from contract inception until the transfer of the asset, the entity adjusts the promised amount of consideration (in accordance with [IFRS 15:65]) and accretes the contract liability by recognising interest on CU4,000 at six per cent for two years:

Interest expense	CU494 ^(a)	
Contract liability		CU494

^(a) CU494 = CU4,000 contract liability × (6 per cent interest per year for two years).

(c) recognise revenue for the transfer of the asset:

Contract liability	CU4,494	
Revenue		CU4,494

Example 7.4.6E

Advance payment and time value of money


Entity A, a homebuilder, is selling apartment units in a new building for which construction has not yet commenced. The estimated time to complete construction is 18 months. Entity A has concluded that its performance obligation (i.e. delivery of the apartment) will be satisfied upon completion of construction, which is also when title and possession are passed to the customer. The cash sales price upon completion of construction is CU500,000. Customers are offered a discount of CU75,000 on the cash sales price if they pay in full in advance; therefore, the price for customers paying in advance is CU425,000.

Entity A has concluded after analysis of the contract that the advance payment represents a significant financing component (i.e. its customers are providing finance to pay for construction costs). On the basis of interest rates in the market, Entity A has concluded that an annual rate of approximately 10 per cent reflects the rate at which Entity A and a customer would have entered into a separate financing transaction. Consequently, Entity A imputes a discount rate of approximately 10 per cent to discount the cash sales price (i.e. CU500,000) to the 'advance' sales price (i.e. CU425,000).

When an advance cash payment is received from a customer, Entity A recognises a contract liability of CU425,000. Subsequently, Entity A accrues interest on the liability balance to accrete the balance to CU500,000 over the 18-month period until it expects its performance obligation to be satisfied. Entity A capitalises the interest in accordance with IAS 23 *Borrowing Costs*. When control of the apartment transfers to the customer, Entity A recognises CU500,000 as revenue.



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The following journal entries illustrate how Entity A should account for the significant financing component.

		CU	CU
Dr	Cash	425,000	
Cr	Contract liability		425,000

To record a contract liability for the CU425,000 received at contract inception.

		CU	CU
Dr	Inventories	75,000	
Cr	Contract liability		75,000

To record the interest accruing on the contract liability over the 18 months from contract inception to the transfer of the asset.

		CU	CU
Dr	Contract liability	500,000	
Cr	Revenue		500,000

To record the revenue arising on the sale of the apartment when control passes to the customer.

Example 7.4.6F

Deferred consideration: discounting on the basis of interest rate

On 1 January 20X1, Entity B sells an item of equipment for CU100,000 under a financing agreement that has no stated interest rate. On the date of sale, Entity B transfers control of the equipment to the customer, and Entity B concludes that the contract meets the criteria in IFRS 15:9 (see 5.1), including the collectability criterion. The first annual instalment of CU20,000 is due on 31 December 20X1, one year from the date of sale, and each subsequent year for five years. The policy of not charging interest is consistent with normal industry practice.


Entity B has separately determined that the transaction includes a significant financing component (see 7.4.3). To estimate the transaction price by discounting the future receipts, Entity B uses a “rate that would be reflected in a separate financing transaction between [Entity B] and its customer at contract inception”. Entity B determines that the appropriate annual rate is 10 per cent. Assume that the receivable arising from the transaction is measured at amortised cost subsequent to initial recognition.

Calculation of the net present value of the stream of payments

If there is no down payment and there are five annual instalments of CU20,000, with an interest rate of 10 per cent, the net present value of the stream of payments forming the consideration is CU75,816. Therefore, upon transfer of control of the equipment, CU75,816 is recognised as revenue from the sale of goods and the related receivable is recognised.



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Calculation of the amount of interest earned in each period

The difference between CU100,000 and CU75,816 (i.e. CU24,184) will be recognised as interest revenue as it becomes due each year, as calculated below.

	Receivable at 1 January	Interest revenue	Payment received	Receivable at 31 December
	CU	CU	CU	CU
	A	B=(A×10%)	C	A+B-C
20X1	75,816	7,581	20,000	63,397
20X2	63,397	6,340	20,000	49,737
20X3	49,737	4,974	20,000	34,711
20X4	34,711	3,471	20,000	18,182
20X5	18,182	1,818	20,000	-
		24,184	100,000	

Journal entries

		CU	CU
Dr	Accounts receivable	75,816	
Cr	Revenue		75,816

To record the revenue arising on the sale when control of the equipment transfers to the customer.

		CU	CU
Dr	Cash	20,000	
Cr	Accounts receivable		12,419
Cr	Interest revenue		7,581

To record the first annual payment due one year from the date of purchase.

At each subsequent year end, Entity B should record the same journal entry using the amounts from the table above.

Note that this example does not take into account any impairment assessment that would be required in accordance with IFRS 9 (or, for entities that have not yet adopted IFRS 9, IAS 39).



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Example 7.4.6G**Deferred consideration: discounting to current cash sales price**

The facts are the same as in **example 7.4.6F**.

If the buyer had paid in full for the equipment at the point of transfer, Entity B estimates that the cash selling price would have been CU76,000.

Assume that the receivable arising from the transaction is measured at amortised cost after initial recognition.

Determination of the discount rate for the customer

IFRS 15:64 indicates that a selling entity may be able to determine the discount rate to be used to adjust the transaction price “by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer”. Therefore, Entity B determines the interest rate that discounts CU100,000 to CU76,000 (i.e. the cash selling price) over a 5-year period, given no down-payment and five annual instalments of CU20,000. This interest rate is approximately 9.91 per cent, which is judged to be consistent with a rate that would be reflected in a separate financing transaction between Entity B and its customer. Upon transfer of the equipment, CU76,000 is recognised as revenue from the sale of goods and the related receivable is recognised.

Calculation of the amount of interest earned in each period

The difference between CU100,000 and CU76,000 (i.e. CU24,000) will be recognised as interest revenue as it becomes due each year, as calculated below.

	Receivable at 1 January	Interest revenue	Payment received	Receivable at 31 December
	CU	CU	CU	CU
	A	B=(A×9.91%)	C	A+B-C
20X1	76,000	7,528	20,000	63,528
20X2	63,528	6,292	20,000	49,820
20X3	49,820	4,935	20,000	34,755
20X4	34,755	3,443	20,000	18,198
20X5	18,198	1,802	20,000	–
		24,000	100,000	


Journal entries

		CU	CU
Dr	Accounts receivable	76,000	
Cr	Revenue		76,000

To record the revenue arising on the sale when control of the equipment transfers to the customer.



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		CU	CU
Dr	Cash	20,000	
Cr	Accounts receivable		12,472
Cr	Interest revenue		7,528

To record the first annual payment due one year from the date of purchase.

At each subsequent year end, Entity B should record the same journal entry by using the amounts from the table above.

Note that this example does not take into account any impairment assessment that would be required in accordance with IFRS 9 (or, for entities that have not yet adopted IFRS 9, IAS 39).

7.4.7 Presentation of the effects of financing

The effects of financing (interest revenue or interest expense) are presented separately from revenue from contracts with customers in the statement of comprehensive income. 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. [IFRS 15:65]

Example 7.4.7

Significant financing component and right of return

[IFRS 15:IE135 – IE140, Example 26]

An entity sells a product to a customer for CU121 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The contract permits the customer to return the product within 90 days. The product is new and the entity has no relevant historical evidence of product returns or other available market evidence.

The cash selling price of the product is CU100, which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception. The entity's cost of the product is CU80.

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 [IFRS 15:56 to 58]. Consequently, revenue is recognised after three months when the right of return lapses.

The contract includes a significant financing component, in accordance with [IFRS 15:60 to 62]. 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.



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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 [IFRS 15:B20 to B27].

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

Asset for right to recover product to be returned	CU80 ⁽ⁱ⁾
Inventory	CU80

⁽ⁱ⁾ 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 [IFRS 15:65] because no contract asset or receivable has been recognised.

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

Receivable	CU100 ⁽ⁱⁱ⁾
Revenue	CU100

Cost of sales	CU80
Asset for product to be returned	CU80


⁽ⁱⁱ⁾ 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.

For entities that have not yet adopted IFRS 9, the references in **example 7.4.7** would instead be to IAS 39 *Financial Instruments: Recognition and Measurement*.



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7.5 Non-cash consideration

When a customer promises consideration in a form other than cash, an entity measures the non-cash consideration (or promise of non-cash consideration) at fair value. [IFRS 15:66]

When the fair value of the non-cash consideration cannot be reasonably estimated, the consideration is measured indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration. [IFRS 15:67]

The fair value of the non-cash consideration may vary because of the form of the consideration (e.g. a change in the price of a share that an entity is entitled to receive from a customer). If the fair value of the non-cash consideration promised by a customer varies for reasons other than only the form of the consideration (e.g. the fair value could vary because of the entity's performance), the requirements in respect of constraining variable consideration are applied (see **7.2.8**). [IFRS 15:68]

If a customer contributes goods or services (e.g. materials, equipment or labour) to facilitate the entity's fulfilment of the contract, the entity should assess whether it has obtained control of those contributed goods or services. If so, the contributed goods or services are accounted for as non-cash consideration received from the customer. [IFRS 15:69]

Example 7.5

Entitlement to non-cash consideration

[IFRS 15, IE156 – IE158, Example 31]


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 [IFRS 15:22(b)]. 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.



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7.6 Consideration payable to a customer

7.6.1 Consideration payable to a customer – general

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 (e.g. 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 should 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 IFRS 15:26 to 30 – see **6.3**) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, the transaction price is estimated (including assessing whether the estimate of variable consideration is constrained) in accordance with IFRS 15:50 to 58 (see **7.2**). [IFRS 15:70]

If consideration payable to a customer is a payment for a distinct good or service from the customer, then an entity should 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 excess is accounted for 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 should account for all of the consideration payable to the customer as a reduction of the transaction price. [IFRS 15:71]

Accordingly, if consideration payable to a customer is accounted for as a reduction of the transaction price, it is recognised when (or as) the later of either of the following events occurs:

[IFRS 15:72]

- (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.

TRG

All payments to customers (or to other parties that purchase the entity's goods or services from customers) that either result from an obligation within a revenue contract (either implicitly or explicitly), or can otherwise be economically linked to a revenue contract with a customer, should be considered subject to the requirements of IFRS 15:70.


Although an entity is not required to separately assess and document each payment made to an entity that has at some point purchased its goods or services, an entity should not disregard payments that extend beyond the context of a specific revenue contract with a customer. Rather, an entity should apply reasonable judgement when determining whether a payment is linked to a revenue contract and, as a result, subject to the guidance on consideration payable to a customer.

For example, an entity may purchase goods from a customer in a separate transaction for an amount that significantly exceeds the fair value of those goods. In such cases, the entity should determine whether the excess price paid is attributable to another transaction (i.e. a revenue contract with the customer).

Once consideration payable to a customer is identified, it should be assessed to determine whether it is in exchange for a distinct good or service (see **7.6.2**) or whether it should be accounted for as a reduction of revenue.



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7.6.2 Consideration payable to a customer – meaning of ‘distinct’ goods or services

IFRS 15:70 refers to IFRS 15:26 to 30 for guidance on the identification of distinct goods or services (see **6.3**). Specifically, in the context of consideration payable to a customer, application of IFRS 15:27 would lead to a determination that goods or services are distinct if both of the following criteria are met:

- the vendor can benefit from the good or service supplied by the customer (either on its own or together with other resources that are readily available to the vendor); and
- the customer’s promise to transfer the good or service to the vendor is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract and the benefit to be received by the vendor is separable from the sale of goods by the vendor to the customer).

IFRS 15:BC256 explains that the principle for assessing whether a good or service is distinct is similar to the concept of an ‘identifiable benefit’ previously applied under US GAAP. An identifiable benefit was described as a good or service that is “sufficiently separable from the [customer’s] purchase of the vendor’s products such that the vendor could have entered into an exchange transaction with a party other than a purchaser of its products or services in order to receive that benefit”.

Examples 7.6.5A to 7.6.5D consider transactions that involve payments by a vendor common in the retail sector and whether the goods or services supplied by the customer in those transactions should be considered to be distinct.

When the vendor concludes that the consideration payable to the customer is for distinct goods or services that the vendor receives, it is also required to assess whether it can reasonably estimate the fair value of those distinct goods or services (see **7.6.4**).

7.6.3 Consideration payable to a customer – identification of the ‘customer’

TRG

IFRS 15:70 specifies that consideration payable to a customer includes payments to “the customer (or to other parties that purchase the entity’s goods or services from the customer)”, making it clear that those requirements apply not only to a direct customer but also to a party further down a distribution or supply chain. For example, ‘consideration payable to a customer’ for a manufacturer selling goods to a retailer could consist not only of payments made by the manufacturer to the retailer but also payments made by the manufacturer to consumers purchasing the manufacturer’s goods from that retailer.

An entity that is acting as an agent (see **3.6**) and arranges for a supplier (the principal) to supply goods to a third party (the end customer) might regard payments made to both of those parties as ‘consideration payable to a customer’.

In addition, a payment from an agent to a principal’s end customer that is contractually required on the basis of an agreement between the agent and the principal will constitute consideration payable to a customer from the agent’s point of view. This will be the case irrespective of whether the agent concludes that the principal’s end customer is also a customer of the agent.



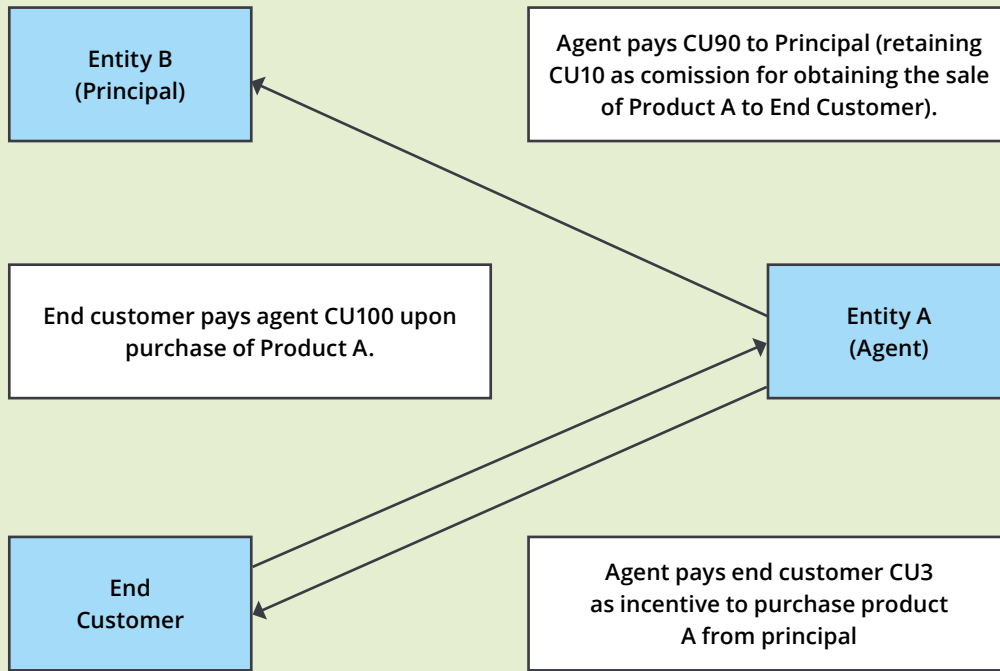
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Example 7.6.3
Identification of a 'customer' for the purposes of the requirements regarding 'consideration payable to a customer'


Entity A enters into an arrangement under which it arranges the sale of Product A on behalf of Entity B. Having considered the guidance in IFRS 15:B34 to 38 (see 3.6), Entity A determines that it is acting as agent in this transaction.

Entity A's payments and receipts of cash under the arrangement are illustrated below.



In this example, if Entity A determines that the CU3 it pays to End Customer as an incentive to purchase Product A from Principal (Entity B) is consideration payable to a customer as described in IFRS 15:70 to 72 (see 7.6.1), it will deduct that CU3 from the CU10 it has received from Principal as commission for making the sale and will recognise revenue of CU7.





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7.6.4 Consideration payable to a customer – determining the transaction price

When a vendor enters into an agreement to sell products to a customer, the transaction with the customer may also involve the customer supplying goods or services to the vendor. The contract may be structured such that the consideration payable by the vendor to the customer for those goods or services is separately identified. Alternatively, the contract may be structured such that it includes a single amount payable by the customer to the vendor which reflects the net of the value of the goods or services provided by the vendor to the customer and by the customer to the vendor.

The vendor will need to consider whether to account for the 'net' consideration as revenue, or whether those goods or services should be accounted for separately (and the transaction price for the goods or services provided by the vendor to the customer increased accordingly).

The goods or services supplied by the customer will be accounted for separately if:

- those goods or services are 'distinct' (see **7.6.2**); and
- the vendor can reasonably estimate the fair value of the goods or services that it will receive (which may not correspond with any amount specified in the contract for those goods or services).

If both of these conditions are met, the fair value of the goods or services received from the customer should be included in the transaction price as non-cash consideration (in accordance with IFRS 15:66 to 69) and should also be recognised as an expense or an asset according to the nature of the goods or services. If any consideration payable to the customer in respect of those goods or services exceeds their fair value, the excess should be accounted for as a reduction in the transaction price.

If either, or both, of these conditions is not met, then any consideration payable to the customer in respect of those goods or services should be accounted for as a reduction in the transaction price.


Therefore, for example, if a vendor sells goods to a customer for CU10,000 and, as part of the same arrangement, pays that customer CU1,000 for the customer to provide a service to the vendor, then:

- if the service is determined to be distinct and its fair value can be reasonably estimated (as being, for example, CU600), the transaction price for the sale of goods should be reduced to CU9,600 (CU10,000 minus the CU400 payment made to the customer in excess of the fair value of the service received); or
- if the service is not determined to be distinct or its fair value cannot be reasonably estimated, the transaction price for the sale of goods should be reduced to CU9,000 (CU10,000 minus the full amount payable to the customer).

These requirements apply irrespective of whether the consideration relating to the goods or services supplied by the customer is separately identified in the contract.



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7.6.5 Consideration payable to a customer – examples

Example 7.6.5A

Consideration payable to a customer

[IFRS 15:IE160 – IE162, Example 32]

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 [IFRS 15:70 to 72] 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 [IFRS 15:70], the CU1.5 million payment is a reduction of the transaction price.

The entity applies the requirements in [IFRS 15:72] 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).

Example 7.6.5B

Consideration payable to a customer – 'slotting fees'


Entity X contracts to sell products to Entity Y, a retailer. As part of the contract, Entity Y promises to display the products in a prime location within its store to encourage sales of those products to the end-customer (payments for such services are commonly referred to as 'slotting fees').

In order to determine the appropriate accounting, Entity X considers whether the services provided by Entity Y are 'distinct'. Entity X concludes that its only substantive benefit from those services will be through additional sales in Entity Y's store and that it would not enter into an exchange transaction with a party other than a purchaser of its products in order to receive that benefit. Therefore, it concludes that the services provided by Entity Y are not sufficiently separable from Entity Y's purchases of Entity X's products to be regarded as distinct.

Accordingly, any payments made to, or discounts provided to, Entity Y in exchange for such slotting services should be accounted for as a reduction of the transaction price recognised by Entity X in accordance with IFRS 15:70 and IFRS 15:72 (see **7.6.4**).



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Example 7.6.5C**Consideration payable to a customer in exchange for inclusion in retailer's advertising circular**

Entity F contracts to sell products to Entity G, a retailer. As part of the contract, Entity G agrees to include Entity F's products in its weekly advertising circular.

In order to determine the appropriate accounting, Entity F considers whether the advertising services provided by Entity G are 'distinct'. Entity F concludes that its only substantive benefit from those services will be through additional sales in Entity G's store and that it would not enter into an exchange transaction with a party other than a purchaser of its products in order to receive that benefit. Therefore, it concludes that the services provided by Entity G are not sufficiently separable from Entity G's purchase of Entity F's products to be regarded as distinct.

Accordingly, any payments made to, or discounts provided to, Entity G in exchange for the inclusion of Entity F's products in Entity G's weekly advertising circular should be accounted for as a reduction of the transaction price recognised by Entity F in accordance with IFRS 15:70 and 72 (see **7.6.4**).

Example 7.6.5D**Consideration payable to a customer in exchange for broadly distributed advertising**

Entity J contracts to sell a particular product to Entity K, a retailer, and also sells that product through other retailers and directly to the public via its website. As part of the contract, Entity K agrees to advertise the sale of Entity J's product in a national newspaper and on national television and radio.


In order to determine the appropriate accounting, Entity J considers whether the advertising services provided by Entity K are 'distinct'. Entity J concludes that it will benefit from the advertising undertaken by Entity K through increased sales in all retail stores which sell the product (not only in Entity K's store) and via its website, and that it would enter into an exchange transaction with a party other than a purchaser of its product in order to receive that benefit (e.g. it could purchase advertising services directly from the national media outlets). Entity J concludes that the services provided by Entity K are sufficiently separable from Entity K's purchase of Entity J's product and are therefore distinct.

Accordingly, Entity J should assess whether it can reasonably estimate the fair value of the advertising services that it will receive (which may not correspond with any amount specified in the contract for those services) (see **7.6.4**). If that fair value can be reasonably estimated, Entity J should include the fair value of those services within the transaction price for the sale of products to Entity K as non-cash consideration (in accordance with IFRS 15:66 to 69) and also recognise that amount as an expense when the advertising services are received.

If the fair value cannot be reasonably estimated, then any consideration payable by Entity J to Entity K in respect of services should be accounted for as a reduction in the transaction price for the sale of goods to Entity K (see **7.6.4**).



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7.7 Customers' unexercised rights - 'breakage'

7.7.1 Customers' unexercised rights - general

IFRS 15:106 requires that, when an entity receives a prepayment from a customer, the entity should recognise a contract liability (in the amount of the prepayment) for its performance obligation to transfer, or to be ready to transfer, goods or services in the future (see **section 13**). The contract liability is derecognised, and revenue is recognised, when those goods or services are transferred (i.e. when the performance obligation is satisfied). [IFRS 15:B44]

When a customer makes a non-refundable prepayment to an entity, the customer has a right to receive a good or service in the future and, therefore, the entity is obliged to be ready to transfer a good or service in the future. However, customers may not always exercise all of their contractual rights; those unexercised rights are often referred to as 'breakage'. [IFRS 15:B45]

If an entity expects to be entitled to a breakage amount in a contract liability, that amount is recognised as revenue in proportion to the pattern of rights exercised by the customer. If an entity does not expect to be entitled to a breakage amount, revenue for the expected breakage amount should be recognised when the likelihood of the customer exercising its remaining rights becomes remote. The guidance on constraining variable consideration in IFRS 15:56 to 58 (see **7.2.8**) should be considered to determine whether an entity expects to be entitled to a breakage amount. [IFRS 15:B46]

An entity should recognise a liability (and not revenue) for any consideration received that is attributable to a customer's unexercised rights which the entity is required to remit to another party (e.g. a government entity in accordance with applicable unclaimed property laws). [IFRS 15:B47]

7.7.2 Changes in expectation of breakage after initial allocation of revenue

Example 7.7.2

Changes in expectation of breakage after initial allocation of revenue

Entity A sells a product to Customer B and, as part of the same transaction, awards Customer B a specific number of loyalty points which can be redeemed at a future date as and when Customer B purchases additional products from Entity A. The sale is made for cash of CU100 and no refund is available to Customer B for unused loyalty points.

In accordance with IFRS 15, Entity A is required to allocate the revenue of CU100 between the product sold and the loyalty points (material rights) which can be redeemed in the future. On the basis of its expectations relating to the level of loyalty points that will not be redeemed (i.e. 'breakage'), Entity A determines that the appropriate allocation is CU80 to the product sold and CU20 to the loyalty points (**example 6.3.5.6A** illustrates the methodology for allocating the transaction price in this scenario).


If, after the initial allocation of revenue, there is a change in estimate regarding the level of breakage, this does not result in an amendment to the allocation of revenue between the product sold and the loyalty points. Although the breakage guidance in IFRS 15:B46 specifically refers to the section on constraining estimates of variable consideration (the 'constraint') in IFRS 15:56 to 58, breakage is not a form of variable consideration because it does not affect the transaction price (in this example, Entity A always remains entitled to the original cash consideration of CU100).

In the absence of variable consideration, the requirement in IFRS 15:59 to reassess the transaction price at the end of each reporting period does not apply and, consequently, a change in the estimate of breakage will not cause the original allocation of CU80 to the product and CU20 to the loyalty points to be amended.

The expected breakage could, however, affect the timing of recognition of revenue in respect of the CU20 allocated to the loyalty points (see **7.7.3**). This is because an entity is required under IFRS 15:B46 to "recognise the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer" if it expects to be entitled to a breakage amount (see **7.7.1**).



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7.7.3 Gift certificates that may not be redeemed

Gift certificates sold by a retailer can be used by the holder to purchase goods up to the amount indicated on the gift certificate. The retailer should assess when to recognise revenue in respect of those gift certificates.

Gift certificates typically represent a non-refundable prepayment to an entity that gives the customer a right to receive goods or services in the future (and obliges the entity to stand ready to transfer the goods or services). Under IFRS 15, revenue should be recognised when (or as) an entity satisfies a performance obligation by transferring a promised good or service to a customer (see 9.1). In this case, the retailer satisfies its performance obligation when the customer redeems the gift certificate and the retailer supplies the associated goods or services to the customer. Accordingly, upon receipt of a prepayment from a customer, the retailer should recognise a contract liability for its performance obligation to transfer, or to stand ready to transfer, the goods or services in the future. The entity should derecognise that contract liability (and recognise revenue) when it transfers those goods or services and, therefore, satisfies its performance obligation.

Customers may not exercise all of their contractual rights for various reasons. IFRS 15 states that such unexercised rights are often referred to as 'breakage'. Under IFRS 15:B44 to B47, revenue arising from the breakage can be recognised before the vendor is legally released from its obligation in some circumstances. The following circumstances are specifically discussed in the Standard:

- IFRS 15:B46 states that "[i]f an entity expects to be *entitled* to a breakage amount in a contract liability, the entity shall recognise the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer" (emphasis added). Under this approach, the estimated value of gift certificates that an entity expects will not be redeemed would be recognised as revenue proportionately as the remaining gift certificates are redeemed. For example, assume that a retailer issues CU1,000 of gift certificates and, in accordance with IFRS 15:56 to 58 (see 7.2.8), expects that CU200 of breakage will result on the basis of a portfolio assessment indicating that 20 per cent of the value of all gift certificates sold will not be redeemed. Therefore, the proportion of the value of gift certificates not expected to be redeemed compared to the proportion expected to be redeemed is 20:80. Each time part of a gift certificate is redeemed, a breakage amount equal to 25 per cent ($20 \div 80$) of the face value of the redeemed amount will be recognised as additional revenue (e.g. if a gift certificate for CU40 is redeemed, the breakage amount released will be CU10, such that the total revenue recognised is CU50).

Entities should not recognise breakage as revenue immediately upon the receipt of payment, even if there is historical evidence to suggest that performance will not be required for a certain percentage of transactions. In IFRS 15:BC400, the IASB notes that it rejected an approach that would have required an entity to recognise estimated breakage as revenue immediately upon the receipt of prepayment from a customer. The IASB decided that, because the entity has not performed under the contract, recognising revenue would not be a faithful depiction of the entity's performance and could also have understated its obligation to stand ready to provide future goods or services.

To determine whether an entity expects to be *entitled* to a breakage amount, an entity should consider the requirements in IFRS 15:56 to 58 on constraining estimates of variable consideration. The entity should use judgement and consider all facts and circumstances when applying this guidance.

- IFRS 15:B46 also states that "[i]f an entity *does not expect to be entitled* to a breakage amount, the entity shall recognise the expected breakage amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote" (emphasis added). For example, assume that a retailer issues CU1,000 of gift certificates and applies the guidance in IFRS 15:56 to 58, but concludes that it does not expect to be entitled to a breakage amount. Each time part of a gift certificate is redeemed, revenue will be recognised equal to the face value of the redeemed amount. Later, after CU800 has been redeemed, the entity may determine that there is only a remote possibility that any of the outstanding gift certificate balances will in due course be redeemed. If so, the entity should release the remaining contract liability of CU200 and recognise revenue of CU200 at that time.



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Allocate the transaction price to the performance obligations

Section 8. Step 4: Allocate the transaction price to the performance obligations in the contract

8.1 Allocation of the transaction price to the performance obligations – general

When allocating the transaction price to each performance obligation, the objective is to allocate amounts that depict the consideration to which the entity expects to be entitled in exchange for transferring each of the performance obligations to the customer. [IFRS 15:73]

IFRS 15 requires the transaction price to be allocated to each performance obligation identified in the contract on a relative stand-alone selling price basis (see **8.2**), subject to exceptions that may be applicable when allocating discounts (see **8.3**) and when allocating consideration that includes variable amounts (see **8.5**). [IFRS 15:74]

The requirements to allocate the transaction price do not apply if a contract has only one performance obligation. However, the requirements for allocating consideration that includes variable amounts (see **8.5**) may apply if an entity promises to transfer a series of distinct goods or services identified as a single performance obligation in accordance with IFRS 15:22(b) (see **section 6**) and the promised consideration includes variable amounts. [IFRS 15:75]

IAS 18 does not include any guidance on how to allocate revenue between the separately identifiable components of a transaction.

In principle, allocation on a stand-alone selling price basis requires a calculation to be performed for each contract containing more than one performance obligation. This may prove a significant logistical challenge for entities with a very large number of different contracts, and in some cases changes to existing systems may be needed.

8.2 Allocation based on stand-alone selling price

8.2.1 Determining the stand-alone selling price of distinct goods and services

As discussed at 8.1, IFRS 15 requires the transaction price to be allocated to each performance obligation identified in the contract on a relative stand-alone selling price basis. The stand-alone selling price of the distinct good or service underlying each performance obligation in the contract is determined at contract inception and the transaction price is allocated in proportion to those stand-alone selling prices. [IFRS 15:76]

The stand-alone selling price is the price at which an entity would sell a promised good or service separately to a customer. The best evidence of the stand-alone selling price is the observable price of a good or service when it is sold separately in similar circumstances and to similar customers. A contractually stated price or a list price for a good or service may be (but is not be presumed to be) the stand-alone selling price. [IFRS 15:77]



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Allocate the transaction price to the performance obligations

Example 8.2.1**Different selling price for the same product over the term of a contract**

Entity A enters into a contract to transfer 1,000 units of Product X to a customer each year for three years. The contract requires the customer to pay CU10 for each unit delivered in Year 1, CU11 for each unit in Year 2, and CU12 for each unit in Year 3.

How should Entity A determine the stand-alone selling price for the units of Product X sold in each of Years 1, 2 and 3?

If the contractually stated price is representative of the value of each distinct good or service for the given period (i.e. it is considered to be the same as the stand-alone selling price), an entity could allocate consideration to the performance obligations based on the contract pricing.

In the circumstances under consideration, Entity A should consider the specific facts and circumstances of the arrangement, as well as the reason for the different selling prices over the term of the contract. For example, if the contract prices have been set to reflect how the market price of Product X is expected to change over the three-year period, it may be appropriate to use the specified contract price as the stand-alone selling price for Product X in each year of the contract.

Conversely, if there is no expectation that the market price of Product X will change over the three-year period, then Entity A may need to determine a single stand-alone selling price to be applied throughout the three-year contract term.

8.2.2 Estimation of the stand-alone selling price when not directly observable

If a stand-alone selling price is not directly observable, it is estimated at an amount that would result in the allocation of the transaction price meeting the objective in IFRS 15:73 (see **8.1**). All information (including market conditions, entity-specific factors and information about the customer or class of customer) that is reasonably available to the entity should be considered when estimating the stand-alone selling price. The use of observable inputs should be maximised for this estimation, and the methods used should be applied consistently in similar circumstances. [IFRS 15:78]

If the stand-alone selling price of a good or service is not directly observable, suitable methods for estimating the price include, but are not limited to:

[IFRS 15:79]

- (a) an adjusted market assessment approach – by evaluating the market in which it sells goods or services, the entity estimates the price that a customer in that market would be willing to pay for those goods or services. This approach may also include referring to prices from competitors for similar goods or services and adjusting those prices as necessary to reflect the entity's costs and margins;
- (b) an expected cost plus a margin approach – by forecasting the expected costs of satisfying a performance obligation and then adding an appropriate margin for that good or service; and
- (c) a residual approach – estimating 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, this approach can only be used 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 (i.e. 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 (i.e. the selling price is uncertain).



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Allocate the transaction price to the performance obligations

8.2.3 Estimation of the stand-alone selling price using a combination of methods

A combination of methods may need to be used to estimate the stand-alone selling prices of the goods or services promised in the contract if two or more of those goods or services have highly variable or uncertain stand-alone selling prices. For example, the residual approach may be used to estimate the aggregate stand-alone selling price for those promised goods or services with highly variable or uncertain stand-alone selling prices, but then another method may be used to further analyse that residual amount so as to estimate the stand-alone selling prices of the individual goods or services within it. [IFRS 15:80]

For example, consider a contract which includes two separate software licences (each of which meets the criteria for using the residual approach to estimate the stand-alone selling price) along with other goods and services for which stand-alone selling prices are directly observable. Each software licence and the other goods and services would be considered distinct performance obligations for the purposes of recognising revenue in accordance with IFRS 15.

In such circumstances, a residual approach may be used to estimate the stand-alone selling price for the two software licences in aggregate, and another method (such as an adjusted market assessment approach) may be used to allocate that single residual amount between the two licences.

When an entity uses a combination of methods, the entity should evaluate whether allocating the transaction price at those estimated stand-alone selling prices is consistent with the allocation objective in IFRS 15:73 (see **8.1**) and the requirements for estimating stand-alone selling prices in IFRS 15:78. [IFRS 15:80]

As discussed above, IFRS 15:78 requires the entity to maximise the use of observable inputs.

Example 8.2.3

Allocation methodology

[IFRS 15:IE164 – IE166, Example 33]

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 price 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 [IFRS 15:78]). The entity estimates the stand-alone selling prices as follows:

Product	Stand-alone selling price	Method
	CU	
Product A	50	Directly observable (see [IFRS 15:77])
Product B	25	Adjusted market assessment approach (see [IFRS 15:79(a)])
Product C	75	Expected cost plus a margin approach (see [IFRS 15:79(b)])
Total	150	



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Allocate the transaction price to the performance obligations

Section 8. Step 4: Allocate the transaction price to the performance obligations in the contract | 8.3 Allocation of a discount

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 [IFRS 15:82 (see 8.3)]) and concludes that it does not. Consequently, in accordance with [IFRS 15:76 and 81], the discount is allocated proportionately across Products A, B and C. The discount, and therefore the transaction price, is allocated as follows:

Product	CU	Allocated transaction price
Product A	33	$(\text{CU}50/\text{CU}150 \times \text{CU}100)$
Product B	17	$(\text{CU}25/\text{CU}150 \times \text{CU}100)$
Product C	50	$(\text{CU}75/\text{CU}150 \times \text{CU}100)$
Total	100	

8.3 Allocation of a discount

When the sum of the stand-alone selling prices of the goods or services promised in the contract exceeds the promised consideration in a contract, the customer has received a discount for purchasing a bundle of goods or services. The discount should be allocated proportionately to all performance obligations in the contract unless there is observable evidence that the entire discount does not relate to all performance obligations in the contract. [IFRS 15:81]

A discount is allocated entirely to one or more, but not all, performance obligations in the contract if all of the following criteria are met:

[IFRS 15:82]

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

When the discount is allocated entirely to one or more performance obligations in the contract in accordance with IFRS 15:82, the allocation is made before using the residual approach to estimate the stand-alone selling price of a good or service in accordance with IFRS 15:79(c) (see 8.2). [IFRS 15:83]

IFRS 15:82 will typically apply only to contracts for which there are at least three performance obligations. This is because an entity could demonstrate that a discount relates to two or more performance obligations when it has observable information supporting the stand-alone selling price of a group of those promised goods or services when they are sold together. The Basis for Conclusions on IFRS 15 notes that it may be possible for an entity to have sufficient evidence to be able to allocate a discount to only one performance obligation in accordance with the criteria in IFRS 15:82, but the IASB expected that this could only occur in rare cases. [IFRS 15:BC283]



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Allocate the transaction price to the performance obligations

Section 8. Step 4: Allocate the transaction price to the performance obligations in the contract | 8.3 Allocation of a discount

Example 8.3 Allocating a discount

[IFRS 15:IE167 – IE177, Example 34]

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

Product	Stand-alone selling price
	CU
Product A	40
Product B	55
Product C	45
Total	140

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

Case A – Allocating a discount to one or more performance obligations

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

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 [IFRS 15:81]). 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 [IFRS 15:82].

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

If the contract requires the entity to transfer control of Products B and C at different points in time, then the allocated amount of CU60 is individually allocated to the promises to transfer Product B (stand-alone selling price of CU55) and Product C (stand-alone selling price of CU45) as follows:

Product	CU	Allocated transaction price
Product B	33	(CU55/CU100 total stand-alone selling price × CU60)
Product C	27	(CU45/CU100 total stand-alone selling price × CU60)
Total	60	



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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 [IFRS 15:79(c)]) 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 [IFRS 15:82 and 83].

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 [IFRS 15:82]. Using the residual approach, the entity estimates the stand-alone selling price of Product D to be CU30 as follows:

Product	Stand-alone selling price	Method
	CU	
Product A	40	Directly observable (see [IFRS 15:77])
Products B and C	60	Directly observable with discount (see [IFRS 15:82])
Product D	30	Residual approach (see [IFRS 15:79(c)])
Total	130	

The entity observes that the resulting CU30 allocated to Product D is within the range of its observable selling prices (CU15 – CU45). Therefore, the resulting allocation (see above table) is consistent with the allocation objective in [IFRS 15:73] and the requirements in [IFRS 15:78].

Case C – Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is CU105 instead of CU130. Consequently, the application of the residual approach would result in a stand-alone selling price of CU5 for Product D (CU105 transaction price less CU100 allocated to Products A, B and C). The entity concludes that CU5 would not faithfully depict the amount of consideration to which the entity expects to be entitled in exchange for satisfying its performance obligation to transfer Product D, because CU5 does not approximate the stand-alone selling price of Product D, which ranges from CU15–CU45. Consequently, the entity reviews its observable data, including sales and margin reports, to estimate the stand-alone selling price of Product D using another suitable method. The entity allocates the transaction price of CU105 to Products A, B, C and D using the relative stand-alone selling prices of those products in accordance with [IFRS 15:73 to 80].


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Allocate the transaction price to the performance obligations

Section 8. Step 4: Allocate the transaction price to the performance obligations in the contract | 8.4 Allocation of a premium

8.4 Allocation of a premium

As noted at **8.3**, when the sum of the stand-alone selling prices of the individual performance obligations in a multiple-element arrangement exceeds the promised consideration, IFRS 15:81 requires any discount under the contract to be allocated proportionately to all performance obligations unless an entity has observable evidence that the entire discount is related only to one or more, but not all, of the performance obligations in the contract. IFRS 15:82 specifies the criteria an entity is required to meet to conclude that the discount does not need to be allocated proportionately to all performance obligations.

IFRS 15 does not, however, explicitly discuss situations in which the promised consideration in a contract exceeds the sum of the stand-alone selling prices of the individual performance obligations, which would suggest that a customer is paying a premium for purchasing the goods or services. Although such situations may not be common, they can arise when, for example, an entity sells its goods or services for a broad range of amounts. In such circumstances, an entity may apply the adjusted market assessment approach described in IFRS 15:79 (see **8.2**) to each performance obligation in the contract, which could result in a determination that the total transaction price of the contract exceeds the aggregate value of stand-alone selling prices of those goods or services.

This scenario is expected to be relatively uncommon and, before assessing how to allocate an apparent premium, an entity should consider the potential that an error, such as one of the following, has been made in the analysis:

- a significant financing component in the contract has not been identified;
- the contract includes an incentive (i.e. performance bonus) that has not been identified;
- additional performance obligations have not been identified; or
- the stand-alone selling prices of performance obligations have not been correctly identified.

If, after further assessment, it is determined that a premium exists, the entity should allocate that premium in a manner consistent with the requirements of IFRS 15 for allocation of a discount (i.e. on a relative stand-alone selling price basis in accordance with IFRS 15:74 (see **8.1**), subject to the exception in IFRS 15:81 to 83).

8.5 Allocation of variable consideration

Variable consideration may be attributable either to the entire contract or to a specific part of the contract, such as either of the following:

[IFRS 15:84]

- one or more, but not all, performance obligations in the contract (e.g. a bonus may be contingent on the transfer of a particular good or service within a specified period of time); or
- one or more, but not all, distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation in accordance with IFRS 15:22(b) (see **section 6**) (e.g. the consideration promised for the second year of a two-year cleaning service contract will increase based on a specified inflation index).

The variable amount (and subsequent changes to that amount) is allocated entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with IFRS 15:22(b) if both of the following criteria are met:



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Allocate the transaction price to the performance obligations

[IFRS 15:85]

- (a) the terms of a variable payment relate specifically to 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) the allocation of the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the objective set out in IFRS 15:73 (see **8.1**) when considering all of the performance obligations and payment terms in the contract.

The allocation requirements in IFRS 15:73 to 83 are applied to allocate the remaining amount of the transaction price that does not meet the criteria in IFRS 15:85. [IFRS 15:86]

Example 8.5 Allocation of variable consideration

[IFRS 15:IE178 – IE187, Example 35]

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 [IFRS 15:53 (see **7.2.1.3**)].

To allocate the transaction price, the entity considers the criteria in [IFRS 15:85] 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 [IFRS 15:85] are met for the following reasons:

- (a) the variable payment relates specifically to an outcome from the performance obligation to transfer Licence Y (ie the customer's subsequent sales of products that use Licence Y).
- (b) allocating the expected royalty amounts of CU1,000 entirely to Licence Y is consistent with the allocation objective in [IFRS 15:73]. 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 [IFRS 15:86]. 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 [IFRS 15:73].

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 [IFRS 15:B63 (see **11.3**)], 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.



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

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

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

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 [IFRS 15:B63], when an entity licenses intellectual property in which the consideration is in the form of a sales-based royalty, the entity cannot recognise revenue until the later of the following events: the subsequent sales occur or the performance obligation is satisfied (or partially satisfied).

Licence Y is transferred to the customer at the inception of the contract and Licence X is transferred three months later. When Licence Y is transferred, the entity recognises as revenue the CU167 ($CU1,000 \div CU1,800 \times CU300$) allocated to Licence Y. When Licence X is transferred, the entity recognises as revenue the CU133 ($CU800 \div CU1,800 \times CU300$) 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 [IFRS 15:B63], the entity recognises as revenue the CU111 ($CU1,000 \div CU1,800 \times CU200$) 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 ($CU800 \div CU1,800 \times CU200$) 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.

8.6 Changes in the transaction price

After the inception of the contract, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances. [IFRS 15:87]

Other than for a contract modification (see **section 10**), any subsequent changes to the transaction price are allocated to the performance obligations on the same basis as at contract inception. Consequently, the transaction price is not reallocated to reflect changes in stand-alone selling prices after contract inception. Amounts allocated to a satisfied performance obligation are recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes. [IFRS 15:88]

A change in the transaction price is allocated entirely to one or more, but not all, performance obligations or distinct goods or services promised in a series that forms part of a single performance obligation in accordance with IFRS 15:22(b) only if the criteria in IFRS 15:85 (see **8.5**) on allocating variable consideration are met. [IFRS 15:89]

A change in the transaction price that arises as a result of a contract modification is accounted for in accordance with IFRS 15:18 to 21 (see **section 10**). When a change in transaction price occurs after a contract modification, IFRS 15 includes additional guidance on how to apply the requirements of IFRS 15:87 to 89, and that additional guidance is described at **10.6**.

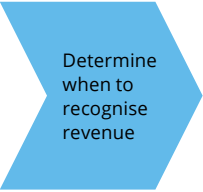


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Section 9. Step 5: Determine when to recognise revenue

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Determine when to recognise revenue

Section 9. Step 5: Determine when to recognise revenue

9.1 Satisfaction of performance obligations

9.1.1 Revenue recognised when (or as) performance obligations are satisfied

Revenue is recognised when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to the customer. An asset is transferred when (or as) the customer obtains control of that asset. [IFRS 15:31]

An entity determines at the inception of the contract whether it satisfies each performance obligation over time (see **9.2**) or at a point in time (see **9.4**). If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time. [IFRS 15:32]

IFRS 15 requires entities to determine whether a performance obligation is satisfied (and revenue is recognised) over time, or whether a performance obligation is satisfied (and revenue is recognised) at a point in time for all contracts. No practical expedients are available that would permit, for example for contracts with a short duration (e.g. less than a year), simply defaulting to point-in-time recognition.

Entities should carefully analyse the contractual arrangement in accordance with the requirements of IFRS 15:35 to determine whether a performance obligation is satisfied over time or at a point in time, even for short-duration contracts.

9.1.2 Meaning of control

Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as:

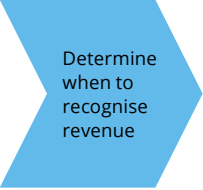
[IFRS 15:33]

- using the asset to produce goods or provide services (including public services);
- using the asset to enhance the value of other assets;
- using the asset to settle liabilities or reduce expenses;
- selling or exchanging the asset;
- pledging the asset to secure a loan; and
- holding the asset.

When evaluating whether a customer obtains control of an asset, an entity should consider any agreement to repurchase the asset (see **3.7**). [IFRS 15:34]



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Determine when to recognise revenue

9.1.3 Application of IFRS 15's model for revenue recognition

Unlike IAS 18, which has separate requirements for goods and for services, IFRS 15 applies a single model (based on control) to all revenue transactions in order to determine when revenue should be recognised. Under the IFRS 15 model, revenue may be recognised over time for some deliverables previously accounted for as goods (e.g. some contract manufacturing). Equally, revenue may be recognised at a point in time for some deliverables previously accounted for as services (e.g. some construction contracts).

For example, it may not necessarily be appropriate for entities that are delivering goods (e.g. contract manufacturers and other customer manufacturing arrangements) to recognise revenue at a particular point in time. Entities should carefully analyse the contractual arrangement in accordance with the three criteria in IFRS 15:35 (see **9.2.1**) to determine whether the promise in the contract to construct and transfer goods to the customer is a performance obligation that will be satisfied over time or at a point in time.

If an entity's obligation to produce a customised product meets one of the criteria in IFRS 15:35 for revenue recognition over time (e.g. the entity's performance does not create an asset with an alternative use, and the entity has an enforceable right to payment for performance completed to date), revenue related to that product would be recognised as the product is *produced*, not when the *product* is delivered to the customer.

For example, an entity that has a contract with an original equipment manufacturer (OEM) to produce a customised part for the OEM's product would meet the criteria for revenue recognition over time if the customised part has no alternative use other than as a part for the OEM's product and the entity has an enforceable right to payment for performance completed to date "at all times throughout the duration of the contract". IFRS 15:36 and 37 as well as IFRS 15:B6 to B13 provide detailed guidance on whether an asset has an alternative use to the entity and whether an entity has an enforceable right to payment for performance completed to date (see **9.2.4**). An entity would need to carefully analyse the contractual arrangements and the specific facts and circumstances to determine whether those criteria are met.

If it concludes that revenue should be recognised over time, the entity would then be required to select a method of recognising revenue over time that most faithfully depicts the entity's performance to date for producing the product (see **9.3**). Therefore, contract revenue and related contract costs should be recognised as revenue and cost of sales when the entity performs (i.e. the products are produced) rather than when the products are delivered to the customer.

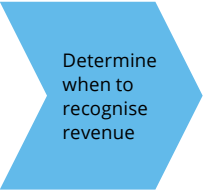
Conversely, it is not always appropriate for entities that are providing a service (e.g. a construction contract) to assume that they meet the criteria and recognise revenue over time. Rather, they need to assess whether the criteria outlined in IFRS 15:35 are met (see **9.2.1**).

The assessment should be made at contract inception. If a contract does not meet any of the criteria set out in IFRS 15:35, the entity should recognise revenue at a point in time rather than over time.

Accordingly, entities that had recognised revenue over time under IAS 11 or IAS 18 should not assume that they will continue to be able to do so under IFRS 15.



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Determine when to recognise revenue

9.2 Revenue recognised over time

9.2.1 Criteria for recognition of revenue over time

When any of the following criteria are met, this demonstrates that the entity is transferring control of a good or service over time (i.e. satisfying a performance obligation over time) and, consequently, should recognise revenue over time:

[IFRS 15:35]

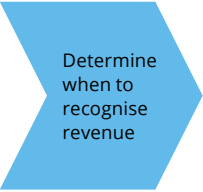
- (a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see **9.2.2**);
- (b) the performance of the entity creates or enhances an asset (e.g. work in progress) that the customer controls as the asset is created or enhanced (see **9.2.3**); or
- (c) the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date (see **9.2.4**).

It is possible for an entity to satisfy more than one of the criteria in IFRS 15:35 – they are not intended to be mutually exclusive. For example, in some cases it may be determined that both criterion (b) and criterion (c) are met.

One of the key changes in IFRS 15 is the basis for the recognition of revenue. For goods, IAS 18 utilised the concept of the transfer of risks and rewards, whereas IFRS 15 utilises the concept of the transfer of control in all cases. Although applying the two different concepts will often not alter the timing of revenue recognition, it is nevertheless possible in some circumstances for entities to have a different pattern of revenue recognition based on a transfer of control as opposed to a transfer of risks and rewards, and this should be taken into careful consideration. It is possible that as a result of IFRS 15, revenue which was previously recognised over time will now be recognised at a point in time, and vice versa.



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Determine when to recognise revenue

9.2.2 Simultaneous receipt and consumption of benefits of the entity's performance

In some cases, it will be straightforward to assess whether a customer receives and simultaneously consumes the benefits of an entity's performance as the entity performs. For example, there are certain routine or recurring services (such as a cleaning service) when the receipt and simultaneous consumption by the customer of the benefits of the performance can be easily identified. [IFRS 15:B3]

In circumstances in which the assessment is not straightforward, a performance obligation is considered to be satisfied over time if the entity can determine that another entity, hypothetically contracted to fulfil the remaining performance obligation, would not need to substantially re-perform the work completed to date. In determining whether this is the case, the entity should make both of the following assumptions:

[IFRS 15:B4]

- (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.

Example 9.2.2

Customer simultaneously receives and consumes the benefits

[IFRS 15:IE67 & IE68, Example 13]

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 [IFRS 15:22(b)]. The performance obligation is satisfied over time in accordance with [IFRS 15:35(a)] 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 [IFRS 15:39 to 45] and [IFRS 15:B14 to B19].

The requirements of IFRS 15:22 on identifying performance obligations are discussed in **section 6**. The requirements of IFRS 15:39 to 45 and B14 to B19 on measuring progress are discussed at **9.3**.

9.2.3 Customer controls the asset as it is created or enhanced

To determine whether a customer controls an asset as it is created or enhanced in accordance with IFRS 15:35(b), an entity should apply the requirements for control (see **9.1** and **9.4**). The asset that is being created or enhanced (e.g. a work-in-progress asset) could be either tangible or intangible. [IFRS 15:B5]

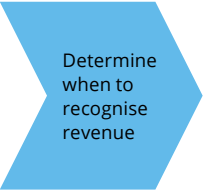
9.2.4 Entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date

9.2.4.1 Third criterion for recognition of revenue over time – general

The third criterion for recognition of revenue over time is that the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date. [IFRS 15:35(c)]



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This third criterion was developed because the IASB observed that, in some cases, applying the criteria in IFRS 15:35(a) and (b) could be challenging. Criterion (c) may be necessary for services that may be specific to a customer (e.g. consulting services that ultimately result in a professional opinion for the customer) but also for the creation of tangible (or intangible) goods. [IFRS 15:BC132]

9.2.4.2 Entity's performance does not create an asset with an alternative use

An asset is considered to have no alternative use to an entity if either:

[IFRS 15:36]

- the entity is restricted by contract from readily directing the asset for another use during the creation or enhancement of that asset; or
- the entity is limited in practice from readily directing the asset in its completed state for another use.

This assessment is made at the inception of the contract, after which an entity does 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 (see **section 10**). [IFRS 15:36]

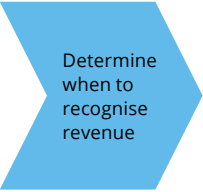
In order to assess whether an asset has an alternative use to an entity in accordance with IFRS 15:36, the entity should consider the effects of contractual restrictions and practical limitations on its ability to readily direct that asset for another use (e.g. selling it to a different customer). The possibility of the contract with the customer being terminated is not relevant to this assessment. [IFRS 15:B6]

A contractual restriction must be substantive in order for the asset not to have an alternative use to the entity, meaning that a customer could enforce its rights to the promised asset if the entity tried 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 it would otherwise not have incurred in relation to that contract. [IFRS 15:B7]

A practical limitation exists if an entity would incur significant economic losses to direct the asset for another use. This could arise because the entity 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. [IFRS 15:B8]



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Example 9.2.4.2**Asset has no alternative use to the entity**

[IFRS 15:IE73 – IE76, Example 15]

An entity enters into a contract with a customer, a government agency, to build a specialised satellite. The entity builds satellites for various customers, such as governments and commercial entities. The design and construction of each satellite differ substantially, on the basis of each customer's needs and the type of technology that is incorporated into the satellite.

At contract inception, the entity assesses whether its performance obligation to build the satellite is a performance obligation satisfied over time in accordance with [IFRS 15:35].

As part of that assessment, the entity considers whether the satellite in its completed state will have an alternative use to the entity. Although the contract does not preclude the entity from directing the completed satellite to another customer, the entity would incur significant costs to rework the design and function of the satellite to direct that asset to another customer. Consequently, the asset has no alternative use to the entity (see [IFRS 15:35(c), 36 and B6 to B8]) because the customer-specific design of the satellite limits the entity's practical ability to readily direct the satellite to another customer.

For the entity's performance obligation to be satisfied over time when building the satellite, [IFRS 15:35(c)] also requires the entity to have an enforceable right to payment for performance completed to date. This condition is not illustrated in this example.

9.2.4.3 Enforceable right to payment for performance completed to date

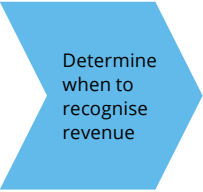
To evaluate whether an enforceable right to payment for performance completed to date exists, the terms of the contract should be considered, as well as any laws that apply to the contract. The right to payment for performance completed to date does not need to be for a fixed amount. However, at all times throughout the contract, the entity must be entitled to an amount that at least compensates it for performance completed to date if the contract is terminated by either the customer, or another party, for reasons other than the entity's failure to perform as promised. [IFRS 15:37]

Such an amount would need to approximate or exceed 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); entitlement only to compensation for the entity's potential loss of profit if the contract were to be terminated is not sufficient. Compensation for a reasonable profit margin need not equal the profit margin expected if the contract was fulfilled as promised, but an entity should at least be entitled to either of the following amounts:

[IFRS 15:B9]

- (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.


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Example 9.2.4.3A**Assessing alternative use and right to payment**

[IFRS 15:IE69 – IE72, Example 14]

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.

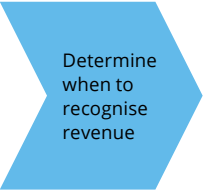
The entity considers the criterion in [IFRS 15:35(a)] and the requirements in [IFRS 15:B3 and B4] to determine whether the customer simultaneously receives and consumes the benefits of the entity's performance. If the entity were to be unable to satisfy its obligation and the customer hired another consulting 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 [IFRS 15:35(a)] is not met.

However, the entity's performance obligation meets the criterion in [IFRS 15:35(c)] and is a performance obligation satisfied over time because of both of the following factors:

- (a) in accordance with [IFRS 15:36 and B6 to B8], 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 [IFRS 15:37 and B9 to B13], 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 [IFRS 15:39 to 45 and B14 to B19 (see **9.3**)].


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Example 9.2.4.3B**Enforceable right to payment for performance completed to date**

[IFRS 15:IE77 – IE80, Example 16]

An entity enters into a contract with a customer to build an item of equipment. The payment schedule in the contract specifies that the customer must make an advance payment at contract inception of 10 per cent of the contract price, regular payments throughout the construction period (amounting to 50 per cent of the contract price) and a final payment of 40 per cent of the contract price after construction is completed and the equipment has passed the prescribed performance tests. The payments are non-refundable unless the entity fails to perform as promised. If the customer terminates the contract, the entity is entitled only to retain any progress payments received from the customer. The entity has no further rights to compensation from the customer.

At contract inception, the entity assesses whether its performance obligation to build the equipment is a performance obligation satisfied over time in accordance with [IFRS 15:35].

As part of that assessment, the entity considers whether it has an enforceable right to payment for performance completed to date in accordance with [IFRS 15:35(c), 37 and B9 to B13] if the customer were to terminate the contract for reasons other than the entity's failure to perform as promised. Even though the payments made by the customer are non-refundable, the cumulative amount of those payments is not expected, at all times throughout the contract, to at least correspond to the amount that would be necessary to compensate the entity for performance completed to date. This is because at various times during construction the cumulative amount of consideration paid by the customer might be less than the selling price of the partially completed item of equipment at that time. Consequently, the entity does not have a right to payment for performance completed to date.

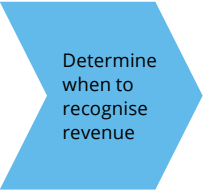
Because the entity does not have a right to payment for performance completed to date, the entity's performance obligation is not satisfied over time in accordance with [IFRS 15:35(c)]. Accordingly, the entity does not need to assess whether the equipment would have an alternative use to the entity. The entity also concludes that it does not meet the criteria in [IFRS 15:35(a) or (b)] and thus, the entity accounts for the construction of the equipment as a performance obligation satisfied at a point in time in accordance with [IFRS 15:38 (see 9.4)].

An entity's right to payment for performance completed to date does not need to be a present unconditional right to payment. In many cases, an unconditional right to payment only exists 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 should 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. [IFRS 15:B10]

In some contracts, a customer does not have the right to terminate the contract, or can only do so at specified times during the life of the contract. If a customer terminates a contract without having the right to do so 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 it 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). [IFRS 15:B11]

An enforceable right to payment would exist if the contract or other laws in the jurisdiction require the entity and the customer to complete their respective obligations. The Basis for Conclusions on IFRS 15 notes that this is often referred to as 'specific performance'. [IFRS 15:BC147]


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As part of this assessment, the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms should be considered, including whether:

[IFRS 15:B12]

- (a) legislation, administrative practice or legal precedent gives the entity a right to payment for performance to date even though it is not specified in the contract with the customer;
- (b) relevant legal precedent indicates that similar rights to payment for performance completed to date in similar contracts have no binding legal effect; or
- (c) the customary business practices of the entity of choosing not to enforce a right to payment has resulted in the right being rendered unenforceable in that legal environment. However, notwithstanding that an entity may choose to waive its right to payment in similar contracts, an entity would continue to have a right to payment to date if, in the contract with the customer, its right to payment for performance to date remains enforceable.

Although it specifies the timing and amount of consideration that is payable by a customer, the payment schedule specified in a contract does not necessarily indicate whether an entity has an enforceable right to payment for performance completed to date. This is because, for example, the contract could specify that the consideration received from the customer is refundable for reasons other than the entity failing to perform as promised in the contract. [IFRS 15:B13]

Example 9.2.4.3C

Assessing whether a performance obligation is satisfied at a point in time or over time

[IFRS 15:IE81 – IE90, Example 17]

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 [IFRS 15:35(c)] 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 [IFRS 15:35(c)]. Instead, the entity accounts for the sale of the unit as a performance obligation satisfied at a point in time in accordance with [IFRS 15:38 (see 9.4)].

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.



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At contract inception, the entity applies [IFRS 15:35(c)] 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 [IFRS 15:37 and B9 to B13]. 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 [IFRS 15:35(c)] 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 [IFRS 15:39 to 45 and B14 to B19 (see 9.3)].

In the construction of a multi-unit residential complex, the entity may have many contracts with individual customers for the construction of individual units within the complex. The entity would account for each contract separately. However, depending on the nature of the construction, the entity's performance in undertaking the initial construction works (ie the foundation and the basic structure), as well as the construction of common areas, may need to be reflected when measuring its progress towards complete satisfaction of its performance obligations in each contract.

Case C – Entity has an enforceable right to payment for performance completed to date

The same facts as in Case B apply to Case C, except that in the event of a default by the customer, either the entity can require the customer to perform as required under the contract or the entity can cancel the contract in exchange for the asset under construction and an entitlement to a penalty of a proportion of the contract price.

Notwithstanding that the entity could cancel the contract (in which case the customer's obligation to the entity would be limited to transferring control of the partially completed asset to the entity and paying the penalty prescribed), the entity has a right to payment for performance completed to date because the entity could also choose to enforce its rights to full payment under the contract. The fact that the entity may choose to cancel the contract in the event the customer defaults on its obligations would not affect that assessment (see [IFRS 15:B11]), 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.

9.2.4.4 Real estate sales – example

Example 9.2.4.4

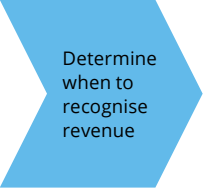
Real estate sales before completion by a property developer

Entity A, a real estate developer, entered into sales and purchase agreements with various buyers before the completion of a property project. The properties are located in Country B. The sales and purchase agreements include the following key terms:

- a specific unit is identified in the contract;
- Entity A is required to complete the property in all respects in compliance with the conditions set out in the sales agreement and the related building plans within two years from the time when the sales contracts are entered into;
- the property remains at Entity A's risk until delivery;
- the buyer is not permitted at any time before delivery to sub-sell the property or transfer the benefit of the agreement. However, the buyer can at any time before the date of assignment mortgage the property in order to finance the acquisition of the property;



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- the sales agreement can be cancelled only when both the buyer and Entity A agree to do so – in effect, the buyer does not have the right to cancel the sales agreement. If both the buyer and Entity A agree to cancel the contract, Entity A has the right to retain 10 per cent of the total purchase price, and the buyer is required to pay for all necessary legal and transaction costs incurred by Entity A in relation to the cancellation;
- if Entity A fails to complete the development of the property within the specified two-year period, the buyer has the right to rescind the sales contract and Entity A is required to repay to the buyer all amounts paid by the buyer together with interest. Otherwise, the buyer does not have a right to cancel the contract; and
- the purchase consideration is payable as follows:
 - 5 per cent of the purchase consideration upon entering into the sales agreement;
 - 5 per cent of the purchase consideration within one month from the date when the sales agreement is entered into;
 - 5 per cent of the purchase consideration within three months from the date when the sales agreement is entered into; and
 - the remaining 85 per cent of the purchase consideration upon delivery of the property.

Note that, for simplicity, this example does not consider whether there is a significant financing element.

Should Entity A recognise revenue over time or at a point in time?

Under IFRS 15, an entity satisfies a performance obligation over time when it transfers control of the promised good or service over time. IFRS 15:35 states that an entity transfers control of a good or service over time and, consequently, 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;
- (b) the entity's performance creates or enhances an asset (e.g. work in progress) that the customer controls as the asset is created or enhanced; or
- (c) the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

Criterion IFRS 15:35(a) is not relevant in determining whether revenue from real estate sales (before completion) should be recognised over time or at a point in time. This is because buyers generally do not consume all of the benefits of the property as the real estate developers construct the property; rather, those benefits are consumed in the future.

Criterion IFRS 15:35(b) is not directly relevant in the circumstances under consideration because, without further consideration of criterion 15:35(c), a conclusion cannot be reached about whether the buyers have control of the property as Entity A develops the property.

Entity A should focus on criterion IFRS 15:35(c), and in particular:

- whether an asset has been created with an alternative use to the real estate developer; and
- whether the real estate developer has an enforceable right to payment for performance completed to date.



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Has an asset been created with an alternative use to Entity A?

In accordance with IFRS 15:36, an asset 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 is limited practically from readily directing the asset in its completed state for another use.

- With regard to contract restriction, IFRS 15:B6 states that 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.
- Because, in the circumstances under consideration, each sales contract specifies the unit to be delivered, the property unit does not have an alternative use to Entity A. The contract precludes Entity A from transferring the specified unit to another buyer.

Does Entity A have an enforceable right to payment for performance completed to date?

- The payment schedule specified in the sales and purchase agreement does not correspond to the performance completed to date. However, in assessing whether it has the right to payment for performance completed to date, Entity A should not only consider the payment schedule, but should also consider the requirements of IFRS 15:B11 (see **9.2.4.3**).
- In the circumstances under consideration, the sales agreement can be cancelled only if both the property developer and the buyer agree to do so. In effect, the buyer does not have the discretion to terminate the contract as it wishes.
- IFRS 15:37 requires an entity to consider the terms of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for performance completed to date. If, taking into account practice and legal precedent in Country B, Entity A has the right to continue to perform the contract and be entitled to all of the consideration as promised, even if the buyer acts to terminate the contract (as articulated in IFRS 15:B11 and B86), Entity A has the enforceable right to payment for performance completed to date.
- The same response (i.e. recognition of revenue over time) applies irrespective of whether Entity A allows buyers to choose to pay the consideration on the basis of the agreed-upon payment schedule or to pay all of the consideration upfront (with a specified percentage of discount given to the buyer).

Should Entity A recognise revenue over time or at a point in time?

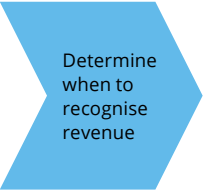
- Because the asset does not have an alternative use to Entity A, and provided that Entity A has an enforceable right to payment for performance completed to date, it should recognise revenue over time. However, if Entity A does not have an enforceable right to payment for the performance completed to date, the criterion in IFRS 15:35(c) is not met and Entity A should recognise revenue at a point in time (i.e. at the point when the control of the property unit is transferred to the buyer, which would normally be at the time of delivery).

9.2.5 Stand-ready obligations

As demonstrated in **example 9.2.5**, an entity may have to identify the nature of the performance obligation in order to assess whether it should recognise revenue over time or at a point in time.



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Example 9.2.5**Unspecified future goods or services in a software arrangement – timing of revenue recognition**

Entity A enters into a contract with a customer that includes two performance obligations: (1) a licence of software, and (2) a promise to provide unspecified upgrades to the software on a ‘when, and if, available’ basis. The unspecified upgrades are different from and extend beyond an assurance type warranty.

How should Entity A recognise revenue for a promise to provide unspecified upgrades to the software?

It depends. When a contract with a customer transfers the rights to unspecified future upgrades or products, judgement is required to determine whether the nature of the promise (performance obligation) is:

- to stand ready to maintain or enhance the software as needed to ensure that the customer can continue to receive and consume the benefit of the software throughout the contract term; or
- to develop and provide a new or significantly enhanced version of the software.

If the nature of the promise represents an obligation by Entity A to stand ready to maintain or enhance the software as needed, the value to the customer transfers over time as Entity A stands ready to perform. That is, the performance obligation is satisfied over time and Entity A should recognise the revenue over time by measuring progress towards complete satisfaction of the performance obligation (see 9.3).

If the nature of the promise represents an implied obligation for Entity A to develop and provide new or significantly enhanced versions of the software through upgrades, the benefit of those upgrades is received and consumed when, and if, they are made available to the customer. That is, the performance obligation is only satisfied at the specific points in time when those upgrades are delivered to the customer (see 9.4).

Note that the discussion above refers to circumstances in which an entity commits to provide unspecified upgrades to a customer; the analysis would likely differ if the entity’s obligation were to deliver specified upgrades because, in many cases, those specified upgrades would be separate performance obligations.

9.3 Measuring progress for revenue recognised over time**9.3.1 Measuring progress for revenue recognised over time – general****9.3.1.1 Recognition of revenue over time when reasonable measure of progress available**

For each performance obligation satisfied over time (see 9.2), revenue is recognised over time by measuring the progress towards complete satisfaction of that performance obligation. The objective is to depict the performance in transferring control of goods or services promised to a customer (i.e. the satisfaction of an entity’s performance obligation). [IFRS 15:39]

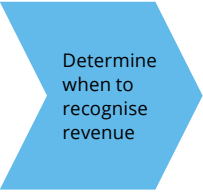
A single method of measuring progress for each performance obligation satisfied over time is applied, and should be applied consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, progress towards complete satisfaction of a performance obligation satisfied over time should be remeasured. [IFRS 15:40]

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When a single performance obligation satisfied over time consists of multiple promised goods and/or services, an entity must still apply a single measure of progress to depict its progress towards complete satisfaction of that performance obligation.

Selecting a single measure of progress that appropriately depicts progress towards complete satisfaction of the performance obligation may be challenging when a single performance obligation contains multiple goods or services or has multiple payment streams. In such circumstances, an entity may need to reassess the performance obligations identified in the contract; this re-examination may result in the identification of more performance obligations than were initially identified.

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There are a number of possible methods of measuring progress, including output methods and input methods (see 9.3.2 to 9.3.4). When determining the appropriate method for measuring progress, the nature of the good or service that the entity promised to transfer to the customer should be considered. [IFRS 15:41]

Example 9.3.1.1

Measuring progress when making goods or services available

[IFRS 15:IE92 – IE94, Example 18]

An entity, an owner and manager of health clubs, enters into a contract with a customer for one year of access to any of its health clubs. The customer has unlimited use of the health clubs and promises to pay CU100 per month.

The entity determines that its promise to the customer is to provide a service of making the health clubs available for the customer to use as and when the customer wishes. This is because the extent to which the customer uses the health clubs does not affect the amount of the remaining goods and services to which the customer is entitled. The entity concludes that the customer simultaneously receives and consumes the benefits of the entity's performance as it performs by making the health clubs available. Consequently, the entity's performance obligation is satisfied over time in accordance with [IFRS 15:35(a)].

The entity also determines that the customer benefits from the entity's service of making the health clubs available evenly throughout the year. (That is, the customer benefits from having the health clubs available, regardless of whether the customer uses it or not.) Consequently, the entity concludes that the best measure of progress towards complete satisfaction of the performance obligation over time is a time-based measure and it recognises revenue on a straight-line basis throughout the year at CU100 per month.

Any goods or services for which the entity has not transferred control to the customer should be excluded from the measurement of progress. [IFRS 15:42]

As circumstances change over time, an entity should update the measure of progress to reflect any changes in the outcome of the performance obligation. These changes are accounted for as a change in accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. [IFRS 15:43]

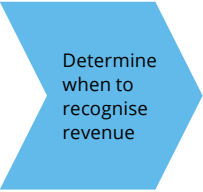
9.3.1.2 Recognition of revenue over time when no reasonable measure of progress available

Revenue is only recognised for a performance obligation satisfied over time if the entity can reasonably measure its progress. This is not possible if the entity lacks reliable information that would be required to apply an appropriate method to measure the progress. [IFRS 15:44]

In some circumstances (e.g. in the early stages of a contract), it may not be possible to reasonably measure the outcome of a performance obligation, but there may be an expectation that the entity will be able to recover the costs incurred in satisfying the performance obligation. In such circumstances, revenue is recognised only to the extent of the costs incurred until such time that the entity can reasonably measure the outcome of the performance obligation. [IFRS 15:45]



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Example 9.3.1.2**Progress towards complete satisfaction of a performance obligation cannot be reasonably measured**

A contractor enters into a building contract with fixed consideration of CU1,000 (i.e. revenue is fixed). The contract is expected to take three years to complete and satisfies one of the criteria in IFRS 15:35 for revenue to be recognised over time. At the end of Year 1, management is unable to reasonably measure its progress towards complete satisfaction of the performance obligation (e.g. because it cannot reasonably measure total costs under the contract). Taking into account the progress to date, management expects that total contract costs will not exceed total contract revenues. Costs of CU100 have been incurred in Year 1.

In these circumstances, because the contractor is not able to reasonably measure the progress towards complete satisfaction of the performance obligation, but expects that costs are recoverable, only revenue of CU100 should be recognised in Year 1. Therefore, in Year 1, revenue and costs of services of CU100 are recognised, resulting in no profit margin.

9.3.2 Selecting a measure of progress towards complete satisfaction of a performance obligation**9.3.2.1 Input method versus output method**

When a performance obligation is satisfied over time, an entity must select a measure of progress (e.g. time elapsed, labour hours, costs incurred) to depict its progress towards complete satisfaction of that obligation.

Under IFRS 15, appropriate methods of measuring progress include:

- output methods (see 9.3.3); and
- input methods (see 9.3.4).

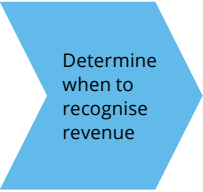
In discussing the selection of a measure of progress, IFRS 15:BC164 states that “[t]he boards decided that, conceptually, an output measure is the most faithful depiction of an entity’s performance because it directly measures the value of the goods or services transferred to the customer. However, the boards observed that it would be appropriate for an entity to use an input method if the method would be less costly and would provide a reasonable proxy for measuring progress”.

The statement in IFRS 15:BC164 does not mean that, when measuring progress towards complete satisfaction of a performance obligation, it is preferable for an entity to use an output method. As stated in IFRS 15:BC159, an entity does not have a free choice when selecting an appropriate method of measuring progress towards complete satisfaction of a performance obligation. It is required to exercise judgement so as to identify a method that fulfils the objective stated in IFRS 15:39 of depicting an entity’s performance in transferring control of goods or services promised to a customer (i.e. the satisfaction of the performance obligation).

Neither input nor output methods are preferred under IFRS 15, because they each have merits and drawbacks that will make them more or less appropriate in the circumstances of a particular contract. While output methods may be, as stated in IFRS 15:BC164, conceptually preferable in a general sense, an appropriate measure of output will not always be directly observable and, in some cases, an apparent measure of output will not in fact provide an appropriate measure of an entity’s performance. It may be that an entity can ascertain the information necessary to apply an input method without undue cost, but care should be taken to ensure that any measure of inputs used is reflective of the transfer of control of goods or services to the customer.



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The following considerations may, among others, be relevant to the selection of a measure of progress.

- An output method will not provide a faithful depiction of the entity's performance if the output selected fails to measure some of the goods or services transferred to the customer. For example, a units-of-delivery or a units-of-production method may in some cases understate an entity's performance by excluding work in progress that is controlled by the customer. [IFRS 15:BC165]
- An input method may better reflect progress towards complete satisfaction of a performance obligation over time when the performance obligation consists of a series of distinct goods or services meeting the criteria in IFRS 15:22(b) (see **6.1.1**) to be treated as a single performance obligation and the effort required to create and deliver the first units is greater than the effort to create the subsequent units due to 'learning curve' efficiencies realised over time. [IFRS 15:BC314]
- An entity applying an input method must exclude from its measure of progress the costs incurred that (1) do not contribute to the entity's progress in satisfying a performance obligation (e.g. the costs of unexpected amounts of wasted materials), and (2) are not proportionate to the entity's progress in satisfying the performance obligation. [IFRS 15:B19]

9.3.2.2 Use of different methods to determine whether a performance obligation is satisfied over time and to measure progress achieved

- If an entity has used a particular method (e.g. a cost-based input method) to measure performance completed to date for the purposes of determining whether the conditions in IFRS 15:35(c) are met (see **9.2.4**), the entity is not required to use that same method for measuring progress towards complete satisfaction of the performance obligation under IFRS 15:39.
- As noted at **9.3.2.1**, IFRS 15 describes various methods for measuring progress, including input and output methods. For the purposes of measuring both performance completed to date under IFRS 15:35(c) and progress toward complete satisfaction of a performance obligation under IFRS 15:39, the method selected should faithfully depict an entity's performance in transferring control of goods or services promised to a customer. However, there is no requirement for the same method to be used for both purposes.
- In determining an appropriate method for measuring progress under IFRS 15:39, entities should be aware of the requirement in IFRS 15:40 that the same method be applied for the purposes of measuring progress towards complete satisfaction of all similar performance obligations in similar circumstances (see **9.3.1.1**).



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Example 9.3.2.2

Use of different methods to determine whether a performance obligation is satisfied over time and to measure progress achieved

Entity A enters into a contract with Customer B under which it will construct a large item of specialised equipment on its own premises and then deliver the equipment and transfer title to Customer B after completion of construction. The specialised equipment is only suitable for Customer B (i.e. it has no alternative use).

Entity A concludes that it qualifies to recognise revenue over time under IFRS 15:35(c) using a cost-based input method because, if Customer B cancels the contract, Customer B must reimburse the costs incurred by Entity A to the date of cancellation plus a 5 per cent margin on those costs (which is considered to be a reasonable margin).

However, in measuring the progress towards satisfaction of similar performance obligations in other contracts, Entity A uses an output method based on surveys of performance completed to date. This method is determined to faithfully depict progress towards satisfaction of the performance obligation in the contract with Customer B. Because IFRS 15:40 requires the same method to be applied for the purposes of measuring progress towards complete satisfaction of similar performance obligations in similar circumstances, Entity A uses this output method to measure the revenue to be recognised in each reporting period from its contract with Customer B.

9.3.2.3 Measuring progress towards complete satisfaction of an over-time stand-ready performance obligation

TRG

IFRS 15:26(e) cites the provision of a service of standing ready to provide goods or services (a 'stand-ready' obligation) as an example of a promise in a contract that an entity should assess to determine whether it is a distinct performance obligation (see **6.3.1**).

The appropriate method to measure progress towards satisfaction of a stand-ready obligation will depend on the particular facts and circumstances, and judgement will be required. In accordance with IFRS 15:39, the method selected should depict the entity's performance in transferring control of the goods or services promised to the customer.

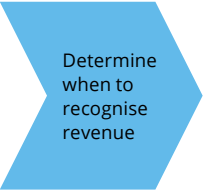
The substance of the stand-ready obligation must be considered in order to select a measure of progress that reflects the nature of the entity's promise underlying that obligation. IFRS 15 does not permit an entity to simply default to a straight-line measure of progress, although a straight-line measure of progress (e.g. one that is based on the passage of time) may be appropriate in many cases.

For example, in a snow removal scenario (see **6.3.7**), the nature of the entity's promise is to stand ready to provide services as and when they are needed (i.e. whenever it snows). However, the entity does not know, and it would likely not be able to reasonably estimate, how often or how much it will snow during a 12-month contract period. The entity may conclude that the customer does not benefit evenly throughout the 12-month period, because it is more likely to snow in the winter months. As a result, the entity may select a measure of progress based on its expectation that greater efforts would be required in the winter months to fulfil its obligation to stand ready to provide snow removal services.

If an entity has a stand-ready obligation to a customer to make unspecified software updates available when and if they become available (see **6.3.7**), the customer benefits evenly throughout the contract period. As a result, a time-based measure of progress over the period during which the customer has the right to such unspecified software updates would generally be appropriate.



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9.3.3 Output methods for measuring progress towards complete satisfaction of a performance obligation

9.3.3.1 Output methods – general

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. Examples of output methods include 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, it should consider whether the output selected would faithfully depict the entity's performance towards complete satisfaction of the performance obligation. This would not be the case if the output selected fails 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 be appropriate 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. [IFRS 15:B15]

Output methods sometimes have disadvantages. 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, it may be necessary to apply an input method (see 9.3.4). [IFRS 15:B17]

9.3.3.2 Practical expedient for measuring progress towards complete satisfaction of a performance obligation based on right to invoice

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 (e.g. a service contract in which an entity bills a fixed amount for each hour of service provided), IFRS 15 provides a practical expedient whereby the entity may recognise revenue based on the amount it has a right to invoice. [IFRS 15:B16]

TRG

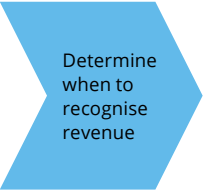
For example, an entity may choose to use the practical expedient for a service contract in which the entity bills a fixed amount for each hour of service provided (see example 14.2.5A (Contract A)).

In some industries, the price charged to the customer for each unit transferred may vary over the contract term. In these circumstances, an entity is not necessarily precluded from applying the practical expedient in IFRS 15:B16, but judgement will be required regarding whether the amount invoiced for goods or services reasonably represents the value to the customer of the entity's performance completed to date. For example, a contract to supply electricity for several years may specify different unit prices each year, based on the forward market price of electricity at contract inception. This contract would qualify for the practical expedient if the rates per unit reflect the value to the customer of the entity's provision of each unit of electricity.

Furthermore, a contract may include non-refundable upfront consideration or back-end fees. Again, this does not necessarily preclude an entity from applying the practical expedient in IFRS 15:B16. Judgement will be required regarding whether the amount invoiced for goods or services reasonably represents the value to the customer of the entity's performance completed to date. In making this assessment, an analysis of the significance of those upfront or back-end fees relative to the other consideration in the arrangement is likely to be important.



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9.3.4 Input methods for measuring progress toward complete satisfaction of a performance obligation

9.3.4.1 Input methods – general

Input methods recognise revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (e.g. resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs required in order to satisfy the 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. [IFRS 15:B18]

However, 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 should exclude the effects of any inputs that, in accordance with the objective of measuring progress in IFRS 15:39 (see **9.3.1**), do not depict the performance of the entity 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:

[IFRS 15:B19]

- (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 which were not reflected in the price of the contract (e.g. the costs of unexpected amounts of wasted materials, labour or other resources); or
- (b) when a cost incurred is not proportionate to the entity's progress in satisfying the performance obligation. When this is the case, 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 may be to recognise revenue at an amount equal to the cost of a good used to satisfy the performance obligation if the entity expects at inception of the contract 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 – see **3.6**).

When an entity uses an input method to measure progress towards complete satisfaction of a performance obligation satisfied over time, it is not appropriate for the entity to include costs incurred to obtain a contract in the measurement of contract costs.

Under cost-based input methods, costs of obtaining a contract should not be included in the measurement of progress to completion because they do not depict the transfer of control of goods or services to the customer. IFRS 15:39 states that an entity's objective, when measuring progress, is to depict its performance in transferring control of goods or services promised to a customer. IFRS 15:B19 also specifies that inputs that do not depict such performance are excluded from the measurement of progress under an input method.

Costs of obtaining a contract are not a measure of fulfilling it and, accordingly, are excluded in the measurement of progress (both from the measure of progress to date and the estimate of total costs to satisfy the performance obligation) irrespective of whether they are recognised as an asset in accordance with IFRS 15:91 (see **12.1**). Such assets are amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates. Accordingly, rather than being used to determine the pattern of revenue recognition, capitalised costs of obtaining a contract are amortised in accordance with the expected pattern of transfer of goods or services.



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Example 9.3.4.1A**Uninstalled materials**

[IFRS 15:IE95 – IE100, Example 19]

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 [IFRS 15:B34 to B38], 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:

A summary of the transaction price and expected costs is as follows:

	CU
Transaction price	5,000,000
Expected costs:	
Elevators	1,500,000
Other costs	2,500,000
Total expected costs	4,000,000

The entity uses an input method based on costs incurred to measure its progress towards complete satisfaction of the performance obligation. The entity assesses whether the costs incurred to procure the elevators are proportionate to the entity's progress in satisfying the performance obligation, in accordance with [IFRS 15:B19]. 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 [IFRS 15:B19], 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:

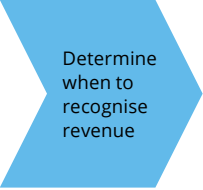
- (a) other costs incurred (excluding elevators) are CU500,000; and
- (b) performance is 20 per cent complete (ie $CU500,000 \div CU2,500,000$).

Consequently, at 31 December 20X2, the entity recognises the following:

	CU
Revenue	2,200,000 ^(a)
Costs of goods sold	2,000,000 ^(b)
Profit	200,000



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- (a) Revenue recognised is calculated as (20 per cent x CU3,500,000) + CU1,500,000. (CU3,500,000 is CU5,000,000 transaction price – CU1,500,000 cost of elevators.)
- (b) Cost of goods sold is CU500,000 of costs incurred + CU1,500,000 costs of elevators.

Example 9.3.4.1B
Treatment of prepaid costs for work to be performed in the future

A contractor undertakes a three-year contract. At the end of Year 1, management estimates that the total revenue for the contract will be CU1,000 and that total costs will be CU900, of which CU300 has been incurred to date. Of the CU300 incurred to date, CU50 is related to materials purchased in Year 1 that will be used in Year 2. The materials purchased in advance are generic in nature and were not specifically produced for the contract. The contractor has determined that the contract is a single performance obligation that will be satisfied over time. The contractor calculates progress on a contract using an input method based on the proportion of costs incurred to date compared to total anticipated contract costs.

IFRS 15:B19 states that “an entity shall exclude from an input method the effects of any inputs that do not depict the entity’s performance in transferring control of goods or services to the customer”.

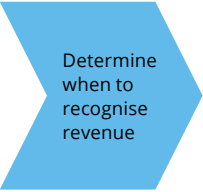
Materials purchased that are yet to be used do not form part of the costs that contribute to the transfer of control of goods or services to the customer. For example, if materials have been purchased that the contractor is merely holding at the job site, and these materials were not specifically produced or fabricated for any projects, transfer of control of such materials will generally not have passed to the customer.

Accordingly, in the circumstances under consideration, an adjustment is required for the purchased materials not yet used as illustrated in the following table.

	CU
Costs incurred to date	300
Less: materials purchased for later years	(50)
Costs incurred for work performed to date	250
Total estimated costs	900
Percentage completion at end of Year 1	28%

Therefore, in Year 1, contract revenue of CU280 (28 per cent of CU1,000) and contract costs of CU250 are recognised in profit or loss. Contract costs of CU50 corresponding to the purchased materials not yet used are recognised as inventories.





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9.3.4.2 Abnormal or unexpected wastage

In many construction and manufacturing contracts, some level of wastage is normal and unavoidable as part of the construction or manufacturing process. Expected levels of wastage will be forecast in an entity's budgets and estimates, and included in contract costs. However, there may be circumstances when an entity experiences significant unexpected levels of wasted materials, labour or other resources. Entities will need to consider how to account for such abnormal wastage.

IFRS 15 contains specific guidance on accounting for costs to fulfil a contract (see **12.3.1**). IFRS 15:98(b) specifies that costs of wasted materials, labour or other resources that are not reflected in the price of the contract should be recognised as expenses when incurred.

Abnormal waste costs do not represent additional progress towards satisfaction of an entity's performance obligation and, if revenue is being recognised over time, should be excluded from the measurement of such progress. If the entity is using costs incurred to date as an input method to measure progress towards complete satisfaction of its performance obligation, it should be careful to ensure that revenue attributed to work carried out is not increased to offset additional costs incurred when abnormal or excessive costs arise as a result of inefficiency or error. In particular, IFRS 15:B19(a) states that, when using a cost-based input method, entities may be required to adjust the measure of progress when costs are incurred that are "attributable to significant inefficiencies in the entity's performance that were not reflected in the price of the contract".

9.3.5 Partial satisfaction of a performance obligation prior to identifying a contract

TRG

Entities sometimes commence activities on a specific anticipated contract with a customer (e.g. construction of an asset) before the parties have agreed to all of the contract terms or before the criteria for identifying the contract in IFRS 15:9 have been satisfied (see **5.1**).

Such activities may result in the transfer of a good or service to the customer at the date the contract meets the criteria in IFRS 15:9 (e.g. when the customer takes control of the partially completed asset) such that a performance obligation meeting the criteria in IFRS 15:35 for recognition of revenue over time is partially satisfied. At that date, the entity should recognise revenue on a cumulative catch-up basis that reflects the entity's progress towards complete satisfaction of the performance obligation.

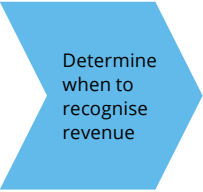
In calculating the required cumulative catch-up adjustment, the entity should consider the requirements in IFRS 15:31 to 45 in respect of determining when a performance obligation is satisfied to determine the goods or services that the customer controls as at the date the criteria in IFRS 15:9 are met.

An entity will also need to consider how to account for fulfilment-type costs incurred in the period prior to the identification of the contract. If other IFRSs are applicable to those costs, the entity should apply the guidance in those other IFRSs. If it is determined that other IFRSs are not applicable, an entity should capitalise such costs as costs to fulfil an anticipated contract, subject to the criteria in IFRS 15:95 (see **12.3.1**). On the date the criteria in IFRS 15:9 are met, such costs would immediately be expensed if they relate to progress made to date or to services already transferred to the customer.

Costs that do not satisfy the criteria in other IFRSs nor in IFRS 15:95 for recognition as an asset (e.g. general and administrative costs that are not explicitly chargeable to the customer under the contract) should be expensed as incurred in accordance with IFRS 15:98.



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Example 9.3.5A**Partial satisfaction of performance obligation prior to identification of the contract (1)**

In this example, assume that the criteria for recognising revenue over time are met. In practice, whether those criteria are met will depend on a careful evaluation of facts and circumstances.

An entity is constructing an apartment block consisting of ten apartments. In the period prior to commencing construction, the entity has signed contracts (meeting the criteria in IFRS 15:9) with customers for six of the apartments in the apartment block but not for the remaining four. The entity uses standard contract terms for each apartment, such that the entity (1) is contractually restricted from readily directing the apartment for another use during its construction, and (2) has an enforceable right to payment for performance completed to date.

For the six apartments for which contracts have been signed with customers, the construction of each apartment represents the transfer of a performance obligation over time because the criteria in IFRS 15:35(c) are met. Accordingly, revenue is recognised as those six apartments are constructed, reflecting progress made to date, and the costs incurred in relation to those six apartments are expensed to the extent that they relate to progress made to date.

For the four apartments for which contracts have not yet been signed with customers, costs are initially capitalised. Subsequently, on the date that a contract is signed with a customer for one of those four apartments and the criteria in IFRS 15:9 are met, a cumulative catch-up of revenue (and expensing of related capitalised costs) should be recognised for that apartment.

Example 9.3.5B**Partial satisfaction of performance obligation prior to identification of the contract (2)**

In this example, assume that the criteria for recognising revenue over time are met. In practice, whether those criteria are met will depend on a careful evaluation of facts and circumstances.

An entity is constructing a piece of specialised equipment to an individual customer's specifications. Because of a delay in obtaining the customer's approval for the contract, the entity commences work on constructing the equipment before the contract is signed. Consequently, the costs that the entity incurs in performing this work are initially capitalised. Subsequently, the contract is approved, and the terms of the contract are such that the criteria for recognition of revenue over time are met. On the date that the contract is signed and the criteria in IFRS 15:9 are met, a cumulative catch-up of revenue (and expensing of capitalised costs), reflecting progress made to date, should be recognised for the partially constructed equipment.

9.4 Revenue recognised at a point in time**9.4.1 Revenue recognised at a point in time – general**

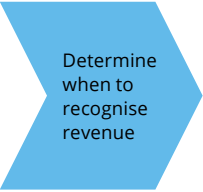
If a performance obligation is not satisfied over time (see 9.2), it is satisfied at a point in time. To determine the point in time at which a customer obtains control of a promised asset (and, therefore, the performance obligation is satisfied), the requirements of IFRS 15:31 to 34 are considered (see 9.1). Indicators of the transfer of control should also be considered; these include, but are not limited to, the following.

[IFRS 15:38]

- (a) The entity has a present right to payment for the asset: if a customer is presently obliged to pay for an asset, this 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.



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- (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. However, 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 (see **example 9.4.1**).
- (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 always 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. Further guidance on such arrangements is set out at **3.8**, and at **9.4.4** and **9.4.5**.
- (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 excludes 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. Further guidance on how to evaluate the effect of a contractual customer acceptance clause on when control of an asset is transferred is considered at **9.4.3**.

The indicators in IFRS 15:38 are not criteria that must be met before an entity can conclude that control of a good or service has been transferred to a customer. Rather, these indicators are factors that are often present if a customer has control of an asset and they are provided to help entities apply the principle of control. [IFRS 15:BC155] However, each indicator may not in isolation be sufficient to demonstrate the transfer of control (as noted in, for example, IFRS 15:38(c) with respect to physical possession of an asset). An entity may therefore need to perform a careful analysis when one or more indicators are not present and the entity believes that control has been transferred.

Appendix B of IFRS 15 includes additional guidance on assessing the transfer of control in contexts such as repurchase agreements, consignment arrangements, bill-and-hold arrangements, customer acceptance and trial-and-evaluation arrangements. When it is appropriate to do so, an entity should apply this guidance in addition to considering the indicators in IFRS 15:38.

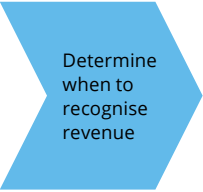
Example 9.4.1

Retention of title to enforce payment

As a matter of policy, a seller writes its sales contracts so that legal title passes when consideration for the goods is received rather than when the goods are delivered. A transaction is entered into at an agreed, fixed price and the related goods are delivered to a customer who is not a particular credit risk. At the point of delivery, the customer accepts and takes physical possession of the goods, and incurs an obligation to pay for the goods. Assume that the criteria for recognising revenue over time are not met.



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In these circumstances, is it appropriate for the seller to recognise revenue when the goods are delivered?

Yes. A core principle in IFRS 15 is that revenue is recognised when (or as) an entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset. As stated in IFRS 15:33 (see **9.1.2**), control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of and obtaining the benefits from an asset.

IFRS 15:38 lists indicators for entities to consider when determining whether control has been transferred (see **above**). The list is not intended to be exhaustive.

In the circumstances described, control of the goods has transferred from the seller to the customer even though title has not. Transfer of title may be an indicator that control of the asset has transferred to the customer, but it is not determinative. IFRS 15:38(b) specifically states that “[i]f an entity retains legal title solely as protection against the customer’s failure to pay, those rights of the entity [are protective rights and] would not preclude a customer from obtaining control of an asset”. Consequently, if other indicators demonstrate that control of the asset has transferred to the customer, revenue should be recognised.

9.4.2 Impact of governing laws

When an entity sells the same item in a number of jurisdictions on exactly the same written contract terms, the timing of revenue recognition may differ between the jurisdictions.

It is not sufficient only to consider written contract terms in determining when control of an asset has been transferred to a customer. IFRS 15 acknowledges that the timing of transfer of control can also be affected by governing laws.

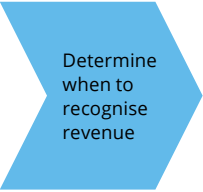
- As indicated in IFRS 15:37 and B12 (see **9.2.4.3**), laws that apply to a contract may affect whether an entity has an enforceable right to payment for performance to date and, consequently, whether revenue should be recognised over time.
- In some jurisdictions, title does not legally transfer until the customer obtains physical possession of the goods.
- In some jurisdictions, property transactions (often residential property transactions) and distance sale transactions (such as sales via internet, phone, mail order or television) are required to include a period during which the customer has an absolute legal right to rescind the transaction (sometimes referred to as a ‘cooling off’ period). For such transactions, it may be appropriate for entities to consider the guidance on whether a contract has been identified under IFRS 15 and when customer acceptance occurs in determining the timing of revenue recognition.

9.4.3 Customer acceptance

IFRS 15:38(e) notes that the 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, and should be considered when evaluating when a customer obtains control of a good or service. [IFRS 15:B83]



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Determine when to recognise revenue

When 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 the customer acceptance is a formality and does 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. 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, consideration should still be given as to whether there are any remaining performance obligations (e.g. installation of equipment) that should be accounted for separately. [IFRS 15:B84]

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 it cannot conclude that the customer has obtained control until the entity receives the customer's acceptance. In this 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. [IFRS 15:B85]

When a product is delivered 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. [IFRS 15:B86]

9.4.4 Consignment arrangements

When an entity delivers a product to another party (such as a dealer or a distributor) for sale to end customers, it should evaluate whether that other party has obtained control of the product at that point in time. A product that has been delivered to another party may be held in a consignment arrangement if that other party has not obtained control of the product. Accordingly, revenue is not recognised upon delivery of a product to another party if the delivered product is held on consignment. [IFRS 15:B77]

Indicators that an arrangement is a consignment arrangement include the following:

[IFRS 15:B78]

- (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).

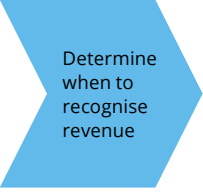
9.4.5 Bill-and-hold arrangements

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 a lack of available space for the product or because of delays in the customer's production schedules. [IFRS 15:B79]

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 – see 9.4.6). However, for other contracts, a customer may obtain control of a product even though the physical possession of the product remains with the entity. 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 and the entity, therefore, does not control the product. Instead, the entity is providing custodial services to the customer over the customer's asset. [IFRS 15:B80]



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In addition to applying the requirements in IFRS 15:38 (see **9.4.1**), all of the following criteria are required to be met for a customer to have obtained control of a product in a bill-and-hold arrangement:

[IFRS 15:B81]

- (a) the reason for the bill-and-hold arrangement must be substantive (e.g. 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.

If an entity recognises revenue for the sale of a product on a bill-and-hold basis, it should consider whether it has remaining performance obligations (e.g. for custodial services) to which a portion of the transaction price should be allocated (see **section 8**). [IFRS 15:B82]

9.4.6 Shipping terms

Under IFRS 15, revenue is recognised when (or as) an entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset. Therefore, in determining when to recognise revenue, an entity should evaluate when the customer obtains control of the asset, by considering how the guidance in IFRS 15 would be applied to the specific fact pattern.

If it is determined that revenue should be recognised at a point in time, an analysis of the shipping terms will form part of the assessment of when control passes. This is because shipping terms will typically specify when title passes and will also affect when the risks and rewards of ownership transfer to the customer; accordingly, they will be relevant in the assessment of two of the five indicators of transfer of control set out in IFRS 15:38 (see **9.4.1**).

If a written sales contract does not explicitly set out shipping terms, the following should be taken into account in determining when control of the goods has transferred to the customer:

- the standard shipping terms in the jurisdiction and in the industry;
- the legal environment of whichever jurisdiction governs the sale transaction; and
- the entity's customary business practices, to the extent that they would be relevant to the contractual terms.



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Example 9.4.6

Goods shipped FOB destination but shipping company assumes risk of loss

Company A, which sells goods 'free on board (FOB) destination' (i.e. title does not pass to the buyer until the goods reach the agreed destination), is responsible for any loss in transit. To protect itself from loss, Company A contracts with the shipping company for the shipping company to assume total risk of loss while the goods are in transit.

Is it appropriate for Company A to recognise revenue when the goods are shipped?

No. Under IFRS 15, Company A can only recognise revenue when it has satisfied its performance obligation by transferring control of the promised goods to the customer. As stated in IFRS 15:33 (see **9.1.2**), control of an asset refers to the ability to direct the use of, and obtain substantially all the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. IFRS 15:38 includes a list of five indicators to determine whether control has been transferred (see **9.4.1**).

Company A has not satisfied the performance obligation when the goods are shipped; the performance obligation is to provide the customer with the goods, whose title and physical possession will only be passed to the customer when the goods reach the agreed destination. Further, the fact that Company A has managed its risk while the goods are in transit by contracting with the shipping company does not mean that it has transferred control of the goods to the customer at the time when the goods are shipped.

After performing the above analysis, Company A determines that control does not pass to the customer until the goods reach the agreed destination.

Generally, when goods are shipped with standard FOB destination shipping terms, control of the goods will be transferred to the customer when the goods arrive at the point of the agreed destination. However, entities should carefully consider both the terms of the contract and other relevant facts and circumstances to determine when control of the goods is transferred to the customer, especially when a contract contains other than standard shipping terms.

When goods are shipped 'free on board (FOB) shipping point', title passes to the buyer when the goods are shipped, and the buyer is responsible for any loss in transit. On the other hand, when goods are shipped FOB destination, title does not pass to the buyer until delivery, and the seller is responsible for any loss in transit.

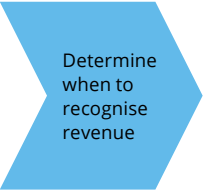
Some sellers use FOB shipping point terms but have practices or arrangements with their customers which result in the seller's continuing to bear risk of loss or damage while the goods are in transit. If there is damage or loss, the seller is obliged to provide (or has a practice of providing) the buyer with replacement products at no additional cost. The seller may insure this risk with a third party or 'self-insure' the risk (however, the seller is not acting solely as the buyer's agent in arranging shipping and insurance in the arrangements). These types of shipping terms are commonly referred to as 'synthetic FOB destination' shipping terms because the seller has retained the risk of loss or damage during transit so that all of the risks and rewards of ownership have not been substantively transferred to the buyer.

The seller will need to evaluate when control of a good transfers to a customer under FOB shipping point terms if the seller has a practice (or an arrangement with the customer) that results in the seller's continuing to bear the risk of loss or damage while the goods are in transit.

When control of a good (that represents a separate performance obligation) is deemed to transfer at a point in time, an entity should use judgement in applying the guidance and indicators provided in IFRS 15 to evaluate the impact of shipping terms and practices in determining when control of the good is transferred to the customer.



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Determine when to recognise revenue

Under typical, unmodified FOB shipping point terms, the seller usually has a legal right to payment upon shipment of the goods; title and risk of loss of/damage to the shipped goods are transferred to the buyer, and the seller transfers physical possession of the shipped goods (assuming that the buyer, not the seller, has the ability to re-direct or otherwise control the shipment through the shipping company). Typically, any customer acceptance term would need to be evaluated separately to determine its impact on when control of a good is transferred to the buyer. However, if the seller can objectively determine that the shipped goods meet the agreed-upon specifications in the contract with the buyer, customer acceptance would be deemed a formality as noted in IFRS 15:B84 (see **9.4.3**). Therefore, under typical unmodified FOB shipping point terms, the buyer would obtain control of the shipped goods, and revenue (subject to the other requirements of IFRS 15) would be recognised upon shipment.

The typical FOB shipping point terms as described above may be modified such that a seller is either (1) obliged to the buyer to replace goods lost or damaged in transit (a legal obligation), or (2) not obliged but has a history of replacing any damaged or lost goods at no additional cost (a constructive obligation). Such an obligation is an indicator that the seller would need to consider in determining when the buyer has obtained control of the shipped goods. In these situations, the seller should evaluate whether the buyer has obtained the 'significant' risks and rewards of ownership of the shipped goods even though the seller maintains the risk of loss of/damage to the goods during shipping. Such evaluation would include (1) a determination of how the obligation assumed by the seller affects the buyer's ability to sell, exchange, pledge, or otherwise use the asset (as noted in IFRS 15:33), and (2) a consideration of the likelihood and potential materiality of lost or damaged goods during shipping. This determination of whether the significant risks and rewards have been transferred would constitute only one indicator (not in itself determinative) of whether the buyer has obtained control of the shipped goods and should be considered along with the other four indicators in IFRS 15:38 (see **9.4.1**). Recognition of revenue upon shipment (subject to the other requirements of IFRS 15) would be appropriate if the seller concludes that the buyer has obtained 'control' of the goods upon shipment (on the basis of an overall evaluation of the indicators in IFRS 15:38 and other guidance in the Standard).

If control is considered to be transferred upon shipment, the seller would be required under IFRS 15:38(d) to consider whether the risk of loss or damage it assumed during shipping gives rise to another performance obligation (a distinct service-type obligation in accordance with IFRS 15:27) and, if so, to account for such obligation separately in accordance with the Standard. For example, such risks may represent another performance obligation if goods are frequently lost or damaged during shipping.



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Section 10. Contract modifications

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Section 10. Contract modifications

10.1 Contract modifications – general

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, it may be described as a 'change order', a 'variation' or an 'amendment'. A contract modification occurs 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. As with the original contract, a contract modification can be approved in writing, by oral agreement or implied by customary business practices. If the contract modification has not yet been approved, IFRS 15 should continue to be applied to the existing contract until the contract modification is approved. [IFRS 15:18]

When the parties to a contract are in dispute about the scope or price (or both) of a modification, or the scope of the contract modification has been approved but the corresponding change in price has not been finalised, it is still possible that a contract modification has occurred. In determining whether the rights and obligations that are created or changed by a modification are enforceable, all relevant facts and circumstances should be considered, including the terms of the contract and other evidence. If the parties to a contract have approved a change in the scope of the contract but have not yet determined the corresponding change in price, the new transaction price arising from the modification should be estimated (see **7.2**). [IFRS 15:19]

Modifications should be treated as an adjustment to the original contract unless they merely add a further performance obligation that is both 'distinct' (as defined by the Standard – see Step 2 above) and priced based on an appropriately adjusted standalone selling price. If both these conditions are met, the modification is treated as a new, separate contract (see **10.2**).

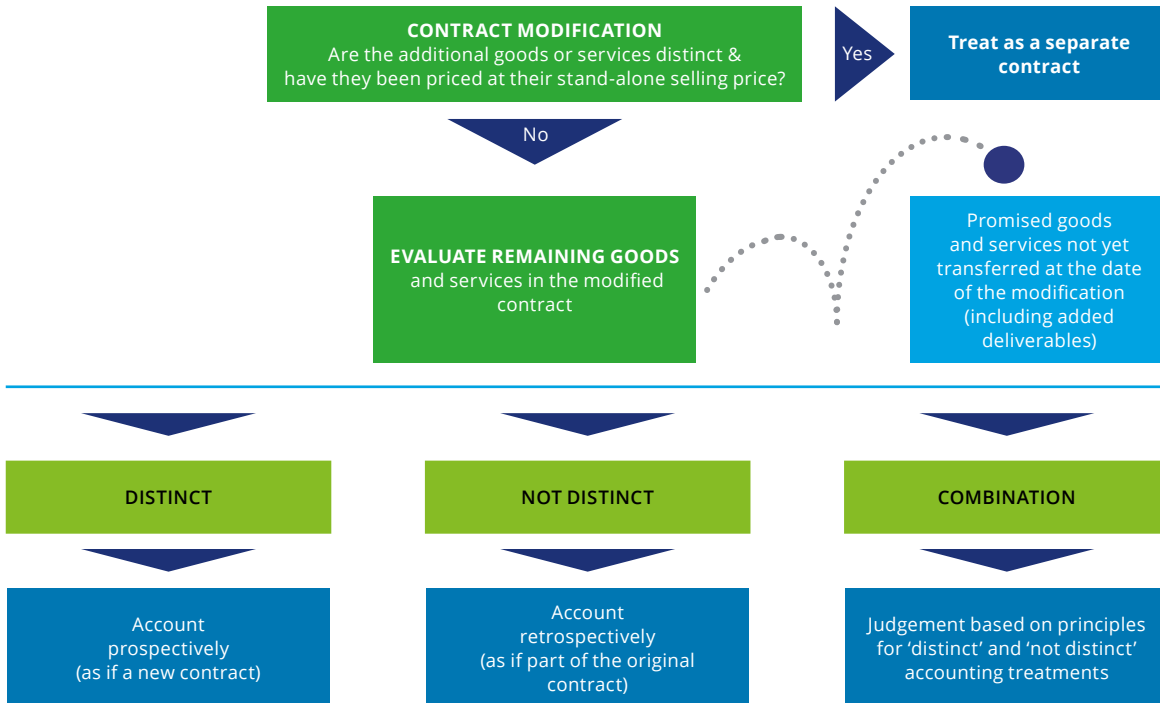
If the modification is treated as an adjustment to the original contract, the appropriate accounting depends on the remaining goods or services to be delivered under the contract (see **10.3**):

- if the remaining goods or services are distinct, the modification is accounted for prospectively by allocating the remaining transaction price to the remaining performance obligations in the contract;
- if the remaining goods or services are not distinct, the modification is accounted for retrospectively, by updating both the transaction price and the measure of progress for the part-complete performance obligation; and
- if the remaining goods or services are a combination of distinct and not distinct, judgement should be used to account for the modification in a manner consistent with the objectives of the contract modification requirements in IFRS 15.



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Contract modification



Previous revenue recognition requirements did not include a general framework for accounting for contract modifications. [IFRS 15:BC76] The approach required by IFRS 15 may be different from that previously applied by an entity.

10.2 Contract modification accounted for as a separate contract

An entity should account for a contract modification as a separate contract if both of the following conditions are met:

[IFRS 15:20]

- the scope of the contract increases because of the addition of promised goods or services that are distinct (see **6.3**); and
- the price of the contract increases by an amount that reflects the stand-alone selling price of the additional promised goods or services, considering 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 the entity does not need to incur the selling-related costs that it would have incurred when selling a similar good or service to a new customer.

If the modification is accounted for as a separate contract, it follows that the original contract is treated as unmodified for the purposes of IFRS 15.



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Example 10.2**Modification of a contract for goods (1)**

[IFRS 15:IE19 – IE21, Example 5 (extract)]

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 [IFRS 15:27]) from the original products.

In accordance with [IFRS 15:20], 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.

10.3 Contract modification not accounted for as a separate contract

If a contract modification is not accounted for as a separate contract in accordance with IFRS 15:20 (see **10.2**), the promised goods or services not yet transferred at the date of the contract modification (i.e. the remaining promised goods or services) should be accounted for as follows.

[IFRS 15:21]

- (a) If the remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification, the contract modification should be accounted for as if it were a termination of the existing contract and the creation of a new contract (see **examples 10.3A** and **10.3B**). 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) 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) 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 contract modification should be accounted for as if it were a part of the existing contract. The effect that the contract modification has on the transaction price, and on the 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 (i.e. on a cumulative catch-up basis) (see **example 10.3C**).
- (c) When the remaining goods or services are a combination of items (a) and (b), the unsatisfied (or partially unsatisfied) performance obligations in the modified contract are accounted for in a manner that is consistent with the objectives above.


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Example 10.3A**Modification of a contract for goods (2)**

[IFRS 15:IE19 & IE22 – IE24, Example 5 (extract)]

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

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

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

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 [IFRS 15:20] 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 [IFRS 15:21(a)] 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 $\{[(CU100 \times 60 \text{ products not yet transferred under the original contract}) + (CU80 \times 30 \text{ products to be transferred under the contract modification})] \div 90 \text{ remaining products}\}$.

Example 10.3B**Modification of a services contract**

[IFRS 15:IE33 – IE36, Example 7]

An entity enters into a three-year contract to clean a customer's offices on a weekly basis. The customer promises to pay CU100,000 per year. The stand-alone selling price of the services at contract inception is CU100,000 per year. The entity recognises revenue of CU100,000 per year during the first two years of providing services. At the end of the second year, the contract is modified and the fee for the third year is reduced to CU80,000. In addition, the customer agrees to extend the contract for three additional years for consideration of CU200,000 payable in three equal annual instalments of CU66,667 at the beginning of years 4, 5 and 6. After the modification, the contract has four years remaining in exchange for total consideration of CU280,000. The stand-alone selling price of the services at the beginning of the third year is CU80,000 per year. The entity's stand-alone selling price at the beginning of the third year, multiplied by the remaining number of years to provide services, is deemed to be an appropriate estimate of the stand-alone selling price of the multi-year contract (ie the stand-alone selling price is 4 years × CU80,000 per year = CU320,000).


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At contract inception, the entity assesses that each week of cleaning service is distinct in accordance with [IFRS 15:27]. Notwithstanding that each week of cleaning service is distinct, the entity accounts for the cleaning contract as a single performance obligation in accordance with [IFRS 15:22(b)]. This is because the weekly cleaning services are a series of distinct services that are substantially the same and have the same pattern of transfer to the customer (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 the date of the modification, the entity assesses the remaining services to be provided and concludes that they are distinct. However, the amount of remaining consideration to be paid (CU280,000) does not reflect the stand-alone selling price of the services to be provided (CU320,000).

Consequently, the entity accounts for the modification in accordance with [IFRS 15:21(a)] as a termination of the original contract and the creation of a new contract with consideration of CU280,000 for four years of cleaning service. The entity recognises revenue of CU70,000 per year ($CU280,000 \div 4$ years) as the services are provided over the remaining four years.

Example 10.3C

Unapproved change in scope and price

[IFRS 15:IE42 & IE43, Example 9]

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 [IFRS 15:18 to 21]. 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 [IFRS 15:21(b)] 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 [IFRS 15:56 to 58] when estimating the transaction price.



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10.4 Treatment of contract assets when the contract is modified

IFRS 15:18 defines a contract modification as a change in the scope or price (or both) of a contract that is approved by the parties to the contract (see **10.1**). IFRS 15:20 and 21 then provide a framework for determining whether a contract modification should be accounted for prospectively or on a cumulative catch-up basis (see **10.2** and **10.3**).

Contract modifications that are treated as a termination of the existing contract and the creation of a new contract are accounted for prospectively under IFRS 15:21(a), which describes how to calculate the amount of consideration to be allocated to the remaining goods or services in the modified contract, specifically mentioning “amounts already received from the customer”, i.e. contract liabilities. However, the Standard does not explicitly describe the required treatment for contract assets in such situations.

It is not appropriate for a contract asset that exists immediately before the modification to be written off (i.e. debited to revenue) at the point of modification. Instead, the contract asset should be retained and taken into account in determining the transaction price for the modified contract.

This issue was discussed by the FASB Transition Resource Group for Revenue Recognition in the context of FASB Accounting Standards Codification (ASC) Topic 606 (the US GAAP equivalent of IFRS 15).

Example 10.4

Treatment of contract assets when the contract is modified

Entity X enters into a contract with a customer to provide services for a six-month period. The contract price for the services is CU600 (CU100 per month) which represents the stand-alone selling price for the services. Payment for the services is made at the end of the six-month period and is conditional on completing all the services under the contract.

At the end of Month 1, Entity X recognises revenue of CU100 relating to the month of services performed. Entity X also recognises a contract asset of CU100 to represent its right to consideration for the services that it has transferred to the customer. (Note that the entity recognises a contract asset rather than a receivable under IFRS 9 *Financial Instruments* (or, for entities that have not yet adopted IFRS 9, IAS 39 *Financial Instruments: Recognition and Measurement*) because the amount is conditional on future services being performed (see **section 2**)).

At the end of Month 4, Entity X has recognised cumulative revenue of CU400 and has a contract asset of CU400. The contract is then modified to include three additional months of the same services beyond the original six-month contract term. Entity X determines that the services to be provided in Months 5 to 9 are distinct from those provided in Months 1 to 4. The CU200 (CU100 a month) due for the last two months of the initial six-month contract is unchanged as a result of the modification. The agreed-upon fee for the additional three months of services is CU50 per month. A payment of CU750 for all of the services (i.e. those under the original contract and the additional payments due as a result of the modification) will be made at the end of the nine-month period and is conditional on completing all the services under the amended contract.

Entity X determines that the additional promised consideration arising from the contract modification does not reflect the stand-alone selling price of the additional services to be provided and that the remaining services are distinct from the services transferred prior to the modification. Entity X therefore accounts for the contract modification in accordance with IFRS 15:21(a).



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Entity X retains the existing contract asset of CU400 that existed at the time of the contract modification. The total amount of consideration to be allocated to the remaining distinct services is CU350 (CU750 to be paid at the end of the contract, as reduced by the contract asset of CU400). This CU350 will be spread over the remaining five months of the contract as services are performed, with revenue of CU70 recognised each month. The contract asset balance will also increase by CU70 each month until the end of the contract, when payment for the services will be received and the contract asset is derecognised.

10.5 Accounting for unamortised capitalised costs to obtain a contract when the contract is modified

IFRS 15:91 requires entities to capitalise incremental costs incurred to obtain a contract with a customer when such costs are expected to be recovered (see **12.2.1**). IFRS 15:99 requires entities to amortise such capitalised costs “on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates” (see **12.4**). The asset may relate to goods or services to be transferred under specific anticipated contracts, which could include contract modifications that are accounted for as separate contracts in accordance with IFRS 15:20 (see **10.2**).

As discussed at **10.3**, when the contract modification does not represent a separate contract, IFRS 15:21(a) provides that, when specified criteria are met, an entity should account for a contract modification “as if it were a termination of the existing contract, and the creation of a new contract”.

It is not appropriate for the unamortised capitalised contract acquisition costs to be written off immediately when the contract is modified. Although the contract modification is accounted for as if it were a termination of the existing contract and the creation of a new contract, the original contract was not in fact terminated (i.e. the modified contract is not a separate contract). Instead, those capitalised contract acquisition costs should be carried forward and amortised on a systematic and rational basis that is consistent with the transfer of goods or services under the modified contract. In assessing the period over which to amortise these costs in the period after the modification, an entity will need to use judgement to identify the goods or services to which the unamortised capitalised acquisition costs relate post-modification. The entity should also consider whether the asset arising from the unamortised capitalised contract acquisition costs is impaired at the time of the contract modification by applying the guidance in IFRS 15:101 and 102 (see **12.4.4**).

10.6 Change in transaction price after a contract modification

When a change in transaction price occurs after a contract modification, the requirements of IFRS 15:87 to 89 (see **8.6**) are applied to allocate the change in the transaction price in one of the following ways.

[IFRS 15:90]

- (a) When the change in the transaction price is attributable to an amount of variable consideration promised before the modification and the modification is accounted for in accordance with IFRS 15:21(a) (i.e. prospectively – see **10.3**), it is allocated to the performance obligations identified in the contract before the modification.
- (b) In all other cases where the modification was not accounted for as a separate contract in accordance with IFRS 15:20, the change in the transaction price is allocated to the performance obligations in the modified contract (i.e. the performance obligations that were unsatisfied or partially unsatisfied immediately after the modification).



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Example 10.6A**Change in the transaction price after a contract modification**

[IFRS 15:IE25 – IE32, Example 6]

On 1 July 20X0, an entity promises to transfer two distinct products to a customer. Product X transfers to the customer at contract inception and Product Y transfers on 31 March 20X1. The consideration promised by the customer includes fixed consideration of CU1,000 and variable consideration that is estimated to be CU200. The entity includes its estimate of variable consideration in the transaction price because it concludes that it is highly probable that a significant reversal in cumulative revenue recognised will not occur when the uncertainty is resolved.

The transaction price of CU1,200 is allocated equally to the performance obligation for Product X and the performance obligation for Product Y. This is because both products have the same stand-alone selling prices and the variable consideration does not meet the criteria in [IFRS 15:85] that requires allocation of the variable consideration to one but not both of the performance obligations.

When Product X transfers to the customer at contract inception, the entity recognises revenue of CU600.

On 30 November 20X0, the scope of the contract is modified to include the promise to transfer Product Z (in addition to the undelivered Product Y) to the customer on 30 June 20X1 and the price of the contract is increased by CU300 (fixed consideration), which does not represent the stand-alone selling price of Product Z. The stand-alone selling price of Product Z is the same as the stand-alone selling prices of Products X and Y.

The entity accounts for the modification as if it were the termination of the existing contract and the creation of a new contract. This is because the remaining Products Y and Z are distinct from Product X, which had transferred to the customer before the modification, and the promised consideration for the additional Product Z does not represent its stand-alone selling price. Consequently, in accordance with [IFRS 15:21(a)], the consideration to be allocated to the remaining performance obligations comprises the consideration that had been allocated to the performance obligation for Product Y (which is measured at an allocated transaction price amount of CU600) and the consideration promised in the modification (fixed consideration of CU300). The transaction price for the modified contract is CU900 and that amount is allocated equally to the performance obligation for Product Y and the performance obligation for Product Z (ie CU450 is allocated to each performance obligation).

After the modification but before the delivery of Products Y and Z, the entity revises its estimate of the amount of variable consideration to which it expects to be entitled to CU240 (rather than the previous estimate of CU200). The entity concludes that the change in estimate of the variable consideration can be included in the transaction price, because it is highly probable that a significant reversal in cumulative revenue recognised will not occur when the uncertainty is resolved. Even though the modification was accounted for as if it were the termination of the existing contract and the creation of a new contract in accordance with [IFRS 15:21(a)], the increase in the transaction price of CU40 is attributable to variable consideration promised before the modification. Therefore, in accordance with [IFRS 15:90], the change in the transaction price is allocated to the performance obligations for Product X and Product Y on the same basis as at contract inception. Consequently, the entity recognises revenue of CU20 for Product X in the period in which the change in the transaction price occurs. Because Product Y had not transferred to the customer before the contract modification, the change in the transaction price that is attributable to Product Y is allocated to the remaining performance obligations at the time of the contract modification. This is consistent with the accounting that would have been required by [IFRS 15:21(a)] if that amount of variable consideration had been estimated and included in the transaction price at the time of the contract modification.


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The entity also allocates the CU20 increase in the transaction price for the modified contract equally to the performance obligations for Product Y and Product Z. This is because the products have the same stand-alone selling prices and the variable consideration does not meet the criteria in [IFRS 15:85] that require allocation of the variable consideration to one but not both of the performance obligations. Consequently, the amount of the transaction price allocated to the performance obligations for Product Y and Product Z increases by CU10 to CU460 each.

On 31 March 20X1, Product Y is transferred to the customer and the entity recognises revenue of CU460. On 30 June 20X1, Product Z is transferred to the customer and the entity recognises revenue of CU460.

Example 10.6B

Modification resulting in a cumulative catch-up adjustment to revenue

[IFRS 15:IE37 – IE41, Example 8]

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 [IFRS 15:35(b)] because the customer controls the building during construction. At the inception of the contract, the entity expects the following:

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

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

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

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



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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 [IFRS 15:56] and includes the CU200,000 in the transaction price. In assessing the contract modification, the entity evaluates [IFRS 15:27(b)] and concludes (on the basis of the factors in [IFRS 15:29]) 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 [IFRS 15:21(b)]). 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.

10.7 Contract modification resulting in a reduction in the scope of a contract

IFRS 15 provides guidance on how to account for a contract modification, which is defined as “a change in the scope or price (or both) of a contract that is approved by the parties to the contract”.

Specifically, IFRS 15:20 notes that a contract modification must be accounted for as a *separate contract* if both of the following criteria are met:

- the scope of the contract *increases* because of the addition of promised goods or services that are distinct; and
- 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.

If the above criteria are not met, the contract modification must be accounted for in accordance with IFRS 15:21 as follows:

- if the remaining goods or services (i.e. those not yet transferred at the date of the modification) are distinct from the goods or services transferred on or before the date of the contract modification, the contract modification is accounted for as if it were a *termination* of the existing contract and *creation of a new contract*; or
- if the remaining goods or services are not distinct from the goods or services transferred on or before the date of the contract modification, the contract modification is accounted for as if it were *a part of the existing contract*, and an adjustment (on a cumulative catch-up basis) is recognised to revenue.

Depending on whether the remaining goods or services in the existing contract are distinct from those transferred prior to the modification, IFRS 15:21 requires an entity to account for a contract modification that results in a decrease in scope (i.e. the removal from the contract of promised goods or services) as either (1) the termination of the existing contract and the creation of a new contract or (2) a cumulative catch-up adjustment to the existing contract.

The modification cannot be accounted for as a separate contract because the criterion in IFRS 15:20(a) specifying an *increase* in scope of the contract is not met.

Examples 10.7A and 10.7B illustrate the appropriate accounting for modifications resulting in a reduction in the scope of a contract.



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Example 10.7A**Contract modification – reduction in the scope of a contract when the remaining goods or services are distinct**

Entity Y enters into a contract with a customer to provide Product X and 12 months of services to be used in conjunction with Product X in return for consideration of CU140; the services portion of the contract qualifies as a series in accordance with IFRS 15:22(b). Product X and the services are each determined to be distinct, with consideration of CU40 allocated to Product X (recognised on transfer of control of Product X) and consideration of CU100 allocated to the services portion of the contract (recognised over the 12-month service period).

Six months after the start of the contract the customer modifies the contract to reduce the level of service required. By the time of this modification, Entity Y has already (1) recognised revenue of CU40 for delivery of Product X, (2) recognised revenue of CU50 for services provided to date and (3) received payment from the customer of CU110. Entity Y agrees to a reduction in price such that the customer will pay only CU10 in addition to the payments already made.

Given that the remaining six months of service are distinct from both the delivery of Product X and those services provided in the first six months of the contract, this decrease in scope (and price) should be accounted for as a termination of the existing contract and the creation of a new contract as required by IFRS 15:21(a), with CU30 allocated to the services still to be provided (i.e. the CU20 previously collected from the customer but not recognised as revenue plus the remaining CU10 due under the modified contract).

Example 10.7B**Contract modification – reduction in scope of a contract when the remaining goods or services are not distinct**

Entity X enters into a contract to produce a single large item of specialised machinery for a customer. Multiple components are used in the production of the specialised machinery, but they are significantly integrated such that Entity X is using the goods as inputs to produce the combined output of the specialised machinery. Four months into the contract term, the customer decides to source a component of the project from an alternative source; Entity X agrees to this contract modification which reduces the contract scope.

Given that the remaining goods or services to be provided are not distinct from those already provided, IFRS 15:21(b) requires Entity X to (1) account for the contract modification as part of the existing contract, and (2) recognise a cumulative catch-up adjustment to revenue at the time the modification occurs.

Example 10.6B illustrates the calculation of a cumulative catch-up adjustment under IFRS 15:21(b).



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Section 11. Licensing

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Section 11. Licensing

11.1 Licensing – general

A licence establishes a customer’s rights to the intellectual property of an entity. Licences of intellectual property may include licences of:

[IFRS 15:B52]

- software and technology;
- motion pictures, music and other forms of media and entertainment;
- franchises; and
- patents, trademarks and copyrights.

In addition to a promise to grant a licence (or licences) to a customer, an entity may also promise to transfer other goods or services to the customer. Such promises may be explicitly stated in the contract or implied by customary business practices, published policies or specific statements (see **6.2**). When a contract with a customer includes a promise to grant a licence (or licences) in addition to other promised goods or services, an entity is required to identify each of the performance obligations in the contract (see **section 6**). [IFRS 15:B53]

If the promise to grant a licence is not distinct from other promised goods or services in the contract (see **6.3**), the promise to grant a licence and the other promised goods or services are accounted for together as a single performance obligation. Examples of licences that are not distinct from other goods or services include:

[IFRS 15:B54]

- a licence that forms a component of a tangible good and that is integral to the functionality of the good; and
- a licence that the customer can benefit from only in conjunction with a related service (such as an online service provided by the entity that enables, by granting a licence, the customer to access content).

When the licence is not distinct, an entity should determine whether the performance obligation (which includes the promised licence) is a performance obligation that is satisfied over time or at a point in time (see **section 9**). [IFRS 15:B55]

IFRS 15:BC407 explains that “[t]he boards noted that in some cases the combined good or service transferred to the customer may have a licence as its primary or dominant component. When the output that is transferred is a licence or when the licence is distinct, the entity would apply the criteria in [IFRS 15:B58 (see **11.2.2**)] to determine whether the promised licence provides the customer with access to the entity’s intellectual property or a right to use the entity’s intellectual property”.

11.2 Determining the nature of the entity’s promise to grant a licence

11.2.1 Requirement to determine the nature of the entity’s promise to grant a licence

When an entity’s promise to grant a licence is distinct from the other promised goods or services in the contract, and is therefore accounted for as a separate performance obligation, an entity is required to determine whether the licence transfers to a customer either at a point in time or over time. In order to assess the appropriate timing of revenue recognition in this case, an entity should consider whether the nature of the entity’s promise in granting the licence to a customer is to provide the customer with:



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[IFRS 15:B56]

- a right to access the entity's intellectual property as it exists throughout the licence period (see **11.2.2**); or
- a right to use the entity's intellectual property as it exists at the point in time at which the licence is granted (see **11.2.3**).

The following factors should be disregarded 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:

[IFRS 15:B62]

- restrictions of time, geographical region or use – these restrictions define the attributes of the promised licence, rather than defining whether the entity satisfies its performance obligation at a point in time or over time; and
- 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.

11.2.2 Entity grants the customer a right to access the entity's intellectual property

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:

[IFRS 15:B58]

- (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;
- (b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities identified in IFRS 15: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.

Customary business practices, published policies and specific statements are some of the factors that may indicate whether a customer could reasonably expect that an entity will undertake activities that significantly affect the intellectual property. The existence of a shared economic interest (e.g. 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. [IFRS 15:B59]

An entity's activities significantly affect the intellectual property to which the customer has rights when either:

[IFRS 15:B59A]

- (a) those activities are expected to significantly change the form (e.g. the design or content) or the functionality (e.g. the ability to perform a function or task) of the intellectual property; or
- (b) the ability of the customer to obtain benefit from the intellectual property is substantially derived from, or dependent upon, those activities. For example, a customer's benefit from a brand is often derived from, or dependent upon, the entity's ongoing activities that support or maintain the value of that brand.

If the intellectual property to which the customer has rights has significant stand-alone functionality, a substantial portion of the benefit of that intellectual property is derived from that functionality. Consequently, the entity's activities do not significantly affect the customer's ability to obtain benefit from that intellectual property unless those activities significantly change the form or functionality of the intellectual property. Examples of intellectual property that often have significant stand-alone functionality include software, biological compounds or drug formulas, and completed media content (e.g. films, television shows and music recordings). [IFRS 15:B59A]



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If the criteria in IFRS 15:B58 are met, the promise to grant a licence is accounted for as a performance obligation satisfied over time because the customer will simultaneously receive and consume the benefit from the entity's performance of providing access to its intellectual property as the performance occurs (see 9.2). It will be necessary to select an appropriate method to measure its progress towards complete satisfaction of that performance obligation to provide access (see 9.3). [IFRS 15:B60]

11.2.3 Entity grants the customer a right to use the entity's intellectual property

If the criteria in IFRS 15:B58 (see 11.2.2) are not met, the entity has in effect provided a right to use the intellectual property as that intellectual property exists (in terms of form and functionality) at the point in time at which the licence is granted to the customer. This means that the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licence at the point in time at which the licence transfers and control is transferred at a point in time (see 9.4). However, revenue cannot be recognised for a licence that provides a right to use the entity's intellectual property before the beginning of the period during which the customer is able to use and benefit from the licence. For example, if a software licence period begins before an entity provides (or otherwise makes available) a code to the customer that enables them to immediately use the software, revenue cannot be recognised until that code has been provided (or otherwise made available). [IFRS 15:B61]

Example 11.2.3A

Electronic delivery of software – assessing when control is transferred to the customer when the licence requires an access code or product key

Entity X sells software licences to customers that represent right-to-use licences (for which revenue is recognised at a point in time) and give customers access to the software via Entity X's web site. Customers need either an access code to download the software or a product key to activate the software once downloaded. The software cannot be used on the customer's hardware without the access code or the product key.

Must Entity X deliver the access code or product key to the customer to conclude that control of the software licence has been transferred to the customer?

No. IFRS 15:B61 states, in part:

"An entity should apply 15:38 to determine the point in time at which the licence transfers to the customer. However, revenue cannot be recognised for a licence that provides a right to use the entity's intellectual property before the beginning of the period during which the customer is able to use and benefit from the licence. For example, if a software licence period begins before an entity provides (or otherwise makes available) to the customer a code that enables the customer to immediately use the software, the entity would not recognise revenue before that code has been provided (or otherwise made available)."
(Emphasis added)

Entity X should consider the guidance on control in IFRS 15:31 to 34 and the indicators in IFRS 15:38 related to determining when a customer obtains control of the software licence.

In some circumstances, control of the software licence may be transferred to the customer before the access code or product key is delivered. In particular, there may be situations in which the access code or product key has not been delivered but is nonetheless made available to the customer at any time on demand. In such circumstances, it will be necessary to consider whether control has passed to the customer by focusing on the indicators in IFRS 15:38. For example, if the customer has accepted the software, non-refundable payment has been received and the licence term has begun, Entity X may conclude that control of the software licence has been transferred even though the access code or product key has not been provided to the customer. These situations may be viewed as analogous to bill-and-hold arrangements as discussed at IFRS 15:B79 to B82 (see 9.4.5).

If payment terms or acceptance depend on delivery of the software access code or product key, or if Entity X is not yet in a position to make the code or key available, it would be unlikely that Entity X could conclude that control of a software licence has been transferred until the access code or product key has been provided to the customer.



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Example 11.2.3B**Electronic delivery of software – assessing when control is transferred to the customer in a hosting agreement**

Entity Y enters into a licence and hosting software arrangement with Customer X that allows Customer X to access via the internet and use software that Entity Y physically hosts on its servers. Customer X is required to pay a non-refundable licence fee of CU1,000 at the inception of the arrangement. Customer X accepts the software, and the licence term begins once the hosting service commences. As part of the arrangement, Customer X has the right to take possession of the software at any time during the contract period without incurring additional costs or diminution of the software's utility or value. That is, there are no contractual or practical barriers to Customer X's exercising its right to take possession of the software and Customer X is able to benefit from the software on its own or with readily available resources.

Entity Y concludes that the software licence and hosting service are each distinct and that the software licence gives Customer X a right to use Entity Y's intellectual property. If Customer X exercises its right to take possession of the software, Entity Y will immediately provide an access code that will enable Customer X to download the software.

When is control of the software licence transferred to Customer X?

In this scenario, Customer X is required to pay the non-refundable licence fee at the inception of the arrangement; Customer X has accepted the software and the licence term begins once the hosting service commences; and the access code is available to Customer X at any time on demand. Therefore, it seems reasonable for Entity Y to conclude that control of the software licence is transferred to Customer X when the licence term and hosting service begin. As a result, the transaction price allocated to the licence is recognised at inception of the arrangement (corresponding to the transfer of control at that point in time) and the transaction price allocated to the hosting service is recognised over time.

Example 11.2.3C**Electronic delivery of software – assessing when control is transferred to the customer for a suite of software licences**

Entity X enters into a five-year licence agreement with Customer B under which Customer B purchases licences to a suite of software products consisting of five modules. At the inception of the arrangement, Customer B is required to make a non-refundable payment of CU5 million to Entity X for the licences to all five modules, and the licence term for the suite of licences begins on 1 January 20X5. Customer B has previewed all five modules and accepted the software as of 1 January 20X5, but has only obtained the access codes for, and downloaded, four of the five modules. Customer B installs the modules itself and expects that it will take three months to install the four modules. Customer B does not download the fifth module immediately because of its own system limitations but plans to obtain the access code and install the fifth module once installation of the first four modules is complete. The access code for the fifth module is available to Customer B on demand.

When is control of the suite of software licences transferred to Customer B?

In this scenario:

- Customer B is required to pay the non-refundable licence fee at the inception of the arrangement and has accepted the software;
- the licence terms have begun; and
- the access code for the fifth module is available to Customer B at any time on demand.

As a result, it seems reasonable for Entity X to conclude that control of the licences for all five modules is transferred to Customer B on 1 January 20X5.



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11.2.4 Determining the nature of the entity's promise to grant a licence – examples accompanying IFRS 15

Example 11.2.4A

Right to use intellectual property

[IFRS 15:IE276 & IE277, Example 54]

Using the same facts as in Case A in Example 11 (see **[example 6.3.1]**), the entity identifies four performance obligations in a contract:

- (a) the software licence;
- (b) installation services;
- (c) software updates; and
- (d) technical support.

The entity assesses the nature of its promise to transfer the software licence in accordance with [IFRS 15:B58]. The entity does not consider in its assessment of the criteria in [IFRS 15:B58 (see **11.2.2**)] the promise to provide software updates, because they result in the transfer of an additional good or service to the customer (see [IFRS 15:B58(c)]). The entity also observes that it does not have any contractual or implied obligations (independent of the updates and technical support) to undertake activities that will change the functionality of the software during the licence period. The entity observes that the software remains functional without the updates and the technical support and, therefore, the ability of the customer to obtain the benefits of the software is not substantially derived from, or dependent on, the entity's ongoing activities. The entity therefore determines that the contract does not require, and the customer does not reasonably expect, the entity to undertake activities that significantly affect the software (independent of the updates and technical support). The entity concludes that the software to which the licence relates has significant stand-alone functionality and none of the criteria in [IFRS 15:B58] are met. The entity further concludes that the nature of the entity's promise in transferring the licence is to provide a right to use the entity's intellectual property as it exists at a point in time. Consequently, the entity accounts for the licence as a performance obligation satisfied at a point in time.

Example 11.2.4B

Licence of intellectual property

[IFRS 15:IE278 – IE280, Example 55]

An entity enters into a contract with a customer to licence (for a period of three years) intellectual property related to the design and production processes for a good. The contract also specifies that the customer will obtain any updates to that intellectual property for new designs or production processes that may be developed by the entity. The updates are integral to the customer's ability to derive benefit from the licence during the licence period, because the intellectual property is used in an industry in which technologies change rapidly.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with [IFRS 15:27 (see **6.3.1**)]. The entity determines that the customer can benefit from (a) the licence on its own without the updates; and (b) the updates together with the initial licence. Although the benefit the customer can derive from the licence on its own (ie without the updates) is limited because the updates are integral to the customer's ability to continue to use the intellectual property in an industry in which technologies change rapidly, the licence can be used in a way that generates some economic benefits. Therefore, the criterion in paragraph [IFRS 15:27(a)] is met for the licence and the updates.



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The fact that the benefit the customer can derive from the licence on its own (ie without the updates) is limited (because the updates are integral to the customer's ability to continue to use the licence in the rapidly changing technological environment) is also considered in assessing whether the criterion in [IFRS 15:27(b)] is met. Because the benefit that the customer could obtain from the licence over the three-year term without the updates would be significantly limited, the entity's promises to grant the licence and to provide the expected updates are, in effect, inputs that together fulfil a single promise to deliver a combined item to the customer. That is, the nature of the entity's promise in the contract is to provide ongoing access to the entity's intellectual property related to the design and production processes for a good for the three-year term of the contract. The promises within that combined item (ie to grant the licence and to provide when-and-if-available updates) are, therefore, not separately identifiable in accordance with the criterion in [IFRS 15:27(b)].

The nature of the combined good or service that the entity promised to transfer to the customer is ongoing access to the entity's intellectual property related to the design and production processes for a good for the three-year term of the contract. On the basis of this conclusion, the entity applies [IFRS 15:31 to 38 (see **section 9**)] to determine whether the single performance obligation is satisfied at a point in time or over time. The entity concludes that because the customer simultaneously receives and consumes the benefits of the entity's performance as it occurs, the performance obligation is satisfied over time in accordance with [IFRS 15:35(a)].

Example 11.2.4C **Identifying a distinct licence**

[IFRS 15:IE281 – IE288, Example 56]

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 [IFRS 15:27 (see **6.3.1**)]. The entity determines that the customer cannot benefit from the licence without the manufacturing service; therefore, the criterion in [IFRS 15:27(a)] 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 [IFRS 15:31 to 38 (see **section 9**)] 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.



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Case B – Licence is distinct

In this case, the manufacturing process used to produce the drug is not unique or specialised and several other entities can also manufacture the drug for the customer.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct, and it concludes that the criteria in [IFRS 15:27 (see **6.3.1**)] are met for each of the licence and the manufacturing service. The entity concludes that the criterion in [IFRS 15:27(a)] is met because the customer can benefit from the licence together with readily available resources other than the entity's manufacturing service (because there are other entities that can provide the manufacturing service), and can benefit from the manufacturing service together with the licence transferred to the customer at the start of the contract.

The entity also concludes that its promises to grant the licence and to provide the manufacturing service are separately identifiable (ie the criterion in [IFRS 15:27(b)] is met). The entity concludes that the licence and the manufacturing service are not inputs to a combined item in this contract on the basis of the principle and the factors in [IFRS 15:29]. In reaching this conclusion, the entity considers that the customer could separately purchase the licence without significantly affecting its ability to benefit from the licence. Neither the licence, nor the manufacturing service, is significantly modified or customised by the other and the entity is not providing a significant service of integrating those items into a combined output.

The entity further considers that the licence and the manufacturing service are not highly interdependent or highly interrelated because the entity would be able to fulfil its promise to transfer the licence independently of fulfilling its promise to subsequently manufacture the drug for the customer. Similarly, the entity would be able to manufacture the drug for the customer even if the customer had previously obtained the licence and initially utilised a different manufacturer. Thus, although the manufacturing service necessarily depends on the licence in this contract (ie the entity would not provide the manufacturing service without the customer having obtained the licence), the licence and the manufacturing service do not significantly affect each other. Consequently, the entity concludes that its promises to grant the licence and to provide the manufacturing service are distinct and that there are two performance obligations:

- (a) licence of patent rights; and
- (b) manufacturing service.

The entity assesses, in accordance with [IFRS 15:B58], the nature of the entity's promise to grant the licence. The drug is a mature product (ie it has been approved, is currently being manufactured and has been sold commercially for the last several years). For these types of mature products, the entity's customary business practices are not to undertake any activities to support the drug. The drug compound has significant stand-alone functionality (ie its ability to produce a drug that treats a disease or condition). Consequently, the customer obtains a substantial portion of the benefits of the drug compound from that functionality, rather than from the entity's ongoing activities. The entity concludes that the criteria in [IFRS 15:B58] 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 [IFRS 15:B58], 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 [IFRS 15:31 to 38 (see **section 9**)] to determine whether the manufacturing service is a performance obligation satisfied at a point in time or over time.



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11.3 Sales-based or usage-based royalties

11.3.1 Sales-based or usage-based royalties – general

Although IFRS 15 includes general guidance on constraining estimates of variable consideration (see **7.2.8**), that guidance does not apply to a sales- or usage-based royalty promised in exchange for a licence of intellectual property.

Instead, revenue for a sales- or usage-based royalty promised in exchange for a licence of intellectual property is recognised only when (or as) the later of the following events occurs:

[IFRS 15:B63]

- the subsequent sale or usage occurs; and
- the performance obligation to which some or all of the sales- or usage-based royalty has been allocated has been satisfied (or partially satisfied).

The requirement in IFRS 15:B63 applies when (1) the royalty relates only to a licence of intellectual property, or (2) a licence of intellectual property is the predominant item to which the royalty relates. The latter may be the case when the entity has a reasonable expectation that the customer would ascribe significantly more value to the licence than to the other goods or services to which the royalty relates. [IFRS 15:B63A]

When the requirement in IFRS 15:B63A is met, revenue from a sales- or usage-based royalty is recognised wholly in accordance with IFRS 15:B63. When the requirement is not met, the variable consideration requirements (see **7.2**) should be applied to the sales- or usage-based royalty. [IFRS 15:B63B]

The application of IFRS 15:B63 to sales- or usage-based royalties is not optional. The exception from IFRS 15's general guidance on constraining estimates of variable consideration is required to be applied in a situation in which the royalty relates only to a licence of intellectual property or in which a licence of intellectual property is the predominant item to which the royalty relates. For example, a professional basketball team licenses its logo to a manufacturer of sports apparel for which it receives a royalty payment for each item of sports apparel sold. Although the professional basketball team has historical experience that is highly predictive of the amount of royalties that it expects to receive, in accordance with IFRS 15:B63 it is precluded from recognising royalty revenue until the later of the actual sale of sports apparel occurring and the entity satisfying the performance obligation to which the sales or usage-based royalty relates (see **11.3.7**).

11.3.2 Scope of application of recognition constraint for sales-based or usage-based royalties

IFRS 15:B63 should be applied by a licensor when accounting for the transfer of a licence of intellectual property promised in exchange for sales- or usage-based royalties; a sale of intellectual property does not qualify for the exception from IFRS 15's general guidance on constraining estimates of variable consideration and, accordingly, should be accounted for under the general revenue measurement and recognition guidance in IFRS 15.

The IASB decided against applying the exception for sales- or usage-based royalties to intellectual property more broadly. As indicated in IFRS 15:BC421, the Board believed that although the exception might not be consistent with the principle of recognising some or all of the estimate of variable consideration, the disadvantage of such an inconsistency in these limited circumstances is outweighed by the simplicity of the exception's requirements, as well as by the relevance of the resulting information for this type of transaction. Further, the Board concluded that the exception should not be applied by analogy to other types of promised goods or services or other types of variable consideration (see IFRS 15:BC415 to BC421 for full discussion).



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Example 11.3.2A

Scope of recognition constraint for sales- or usage-based royalties – licence of intellectual property

Entity X provides its customer with a licence to broadcast one of Entity X's movies on the customer's networks in exchange for a royalty of CU10,000, which is payable each time the movie is broadcast over the five-year licence period. Entity X considers the guidance in IFRS 15:B58 to B62 and concludes that Entity X has promised to its customer a right to use Entity X's intellectual property (i.e. Entity X has satisfied its performance obligation at the point in time at which the customer is able to use and benefit from the licence).

Entity X applies the requirements of IFRS 15:B63 and does not recognise any revenue when the licence is transferred to the customer. Instead, Entity X recognises revenue of CU10,000 each time the customer uses the licensed intellectual property and broadcasts Entity X's movie.

Example 11.3.2B

Scope of recognition constraint for sales- or usage-based royalties – sale of intellectual property

Entity X sells the copyright to one of its music albums (i.e. all rights related to the intellectual property) to a customer in exchange for a promise of future payments equal to CU1 for each album sold by the customer in the future and CU0.01 for each time a song on the album is played on the radio. Entity X considers the guidance in IFRS 15:31 to 38 and determines that its performance obligation is satisfied at the point in time that it transfers the copyright to the customer.

In accordance with IFRS 15:47 to 48, upon transferring control of the intellectual property to the customer, Entity X recognises revenue equal to its estimate of the amount to which it will be entitled, subject to the constraint on variable consideration specified by IFRS 15:56 and 57. Entity X then updates its estimate and records a cumulative catch-up adjustment at each subsequent reporting period as required by IFRS 15:59.

11.3.3 Sales-based or usage-based royalties – examples accompanying IFRS 15

Example 11.3.3A

Franchise rights

[IFRS 15:IE289 – IE296, Example 57]

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.

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 [IFRS 15:27 (see 6.3.1)]. The entity observes that the entity, as a franchisor, has developed a customary business practice to undertake activities such as analysing consumers' 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.



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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 each distinct. This is because the customer can benefit from each good or service (ie the licence and the equipment) on its own or together with other resources that are readily available (see [IFRS 15:27(a)]). (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 promises to grant the franchise licence and to transfer the equipment are separately identifiable, in accordance with the criterion in [IFRS 15:27(b)]. The entity concludes that the licence and the equipment are not inputs to a combined item (ie they are not fulfilling what is, in effect, a single promise to the customer). In reaching this conclusion, the entity considers that it is not providing a significant service of integrating the licence and the equipment into a combined item (ie the licensed intellectual property is not a component of, and does not significantly modify, the equipment). In addition, the licence and the equipment are not highly interdependent or highly interrelated because the entity would be able to fulfil each promise (ie to license the franchise or to transfer the equipment) independently of the other. 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 stand-alone selling price of the equipment is CU150,000 and the entity regularly licenses franchises in exchange for five per cent of customer sales.

The entity applies [IFRS 15:85 (see **8.5**)] 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. 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 [IFRS 15:B58], the nature of the entity's promise to grant the franchise licence. The entity concludes that the criteria in [IFRS 15:B58 (see **11.2.2**)] 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 significantly affect the intellectual property to which the customer has rights. The ability of the customer to obtain benefit from the intellectual property to which the customer has rights is substantially derived from, or dependent upon, the expected activities of the entity. This is on the basis of the entity's customary business practice to undertake activities such as analysing consumers' 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.



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- (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 [IFRS 15:B58] are met, the entity concludes that the promise to transfer the licence is a performance obligation satisfied over time in accordance with [IFRS 15:35(a) (see 9.2.1)].

The entity also concludes that because the consideration that is in the form of a sales-based royalty relates specifically to the franchise licence (see [IFRS 15:B63A]), the entity applies [IFRS 15:B63]. After the transfer of the franchise licence, the entity recognises revenue as and when the customer's sales occur because the entity concludes that this reasonably depicts the entity's progress towards complete satisfaction of the franchise licence performance obligation.

Example 11.3.3B

Access to intellectual property [comic strips]

[IFRS 15:IE297 – IE302, Example 58]

An entity, a creator of comic strips, licenses the use of the images and names of its comic strip characters in three of its comic strips to a customer for a four-year term. There are main characters involved in each of the comic strips. However, newly created characters appear regularly and the images of the characters evolve over time. The customer, an operator of cruise ships, can use the entity's characters in various ways, such as in shows or parades, within reasonable guidelines. The contract requires the customer to use the latest images of the characters.

In exchange for granting the licence, the entity receives a fixed payment of CU1 million in each year of the four-year term.

In accordance with [IFRS 15:27 (see 6.3.1)], the entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity concludes that it has no other performance obligations other than the promise to grant a licence. That is, the additional activities associated with the licence do not directly transfer a good or service to the customer because they are part of the entity's promise to grant a licence.

The entity assesses the nature of the entity's promise to transfer the licence in accordance with [IFRS 15:B58 (see 11.2.2)]. In assessing the criteria the entity considers the following:

- (a) the customer reasonably expects (arising from the entity's customary business practices) that the entity will undertake activities that will significantly affect the intellectual property to which the customer has rights (ie the characters). This is because the entity's activities (ie the development of the characters) change the form of the intellectual property to which the customer has rights. In addition, the ability of the customer to obtain benefit from the intellectual property to which the customer has rights is substantially derived from, or dependent upon, the entity's ongoing activities (ie the publishing of the comic strip).
- (b) the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities because the contract requires the customer to use the latest characters.
- (c) even though the customer may benefit from those activities through the rights granted by the licence, they do not transfer a good or service to the customer as those activities occur.



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Consequently, the entity concludes that the criteria in [IFRS 15:B58] are met and that the nature of the entity's promise to transfer the licence is to provide the customer with access to the entity's intellectual property as it exists throughout the licence period. Consequently, the entity accounts for the promised licence as a performance obligation satisfied over time (ie the criterion in [IFRS 15:35(a)] (see **9.2.1**) is met).

The entity applies [IFRS 15:39 to 45] (see **9.3.1**) 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.

Example 11.3.3C

Right to use intellectual property [music recording]

[IFRS 15:IE303 – IE306, Example 59]

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 [IFRS 15:27] (see **6.2.1**). The entity concludes that its only performance obligation is to grant the licence. The entity determines that the term of the licence (two years), its geographical scope (the customer's right to use the recording only in Country A), and the defined permitted use for the recording (in commercials) are all attributes of the promised licence in the contract.

In accordance with [IFRS 15:B58] (see **11.2.2**), the entity assesses the nature of the entity's promise to grant the licence. The entity does not have any contractual or implied obligations to change the licensed recording. The licensed recording has significant stand-alone functionality (ie the ability to be played) and, therefore, the ability of the customer to obtain the benefits of the recording is not substantially derived from the entity's ongoing activities. The entity therefore determines that the contract does not require, and the customer does not reasonably expect, the entity to undertake activities that significantly affect the licensed recording (ie the criterion in [IFRS 15:B58(a)] is not met). Consequently, the entity concludes that the nature of its promise in transferring the licence is to provide the customer with a right to use the entity's intellectual property as it exists at the point in time that it is granted. Therefore, the promise to grant the licence is a performance obligation satisfied at a point in time. The entity recognises all of the revenue at the point in time when the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licensed intellectual property.

Because of the length of time between the entity's performance (at the beginning of the period) and the customer's monthly payments over two years (which are non-cancellable), the entity considers the requirements in [IFRS 15:60 to 65] (see **7.4**) to determine whether a significant financing component exists.



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Example 11.3.3D

Sales-based royalty for a licence of intellectual property [movie distribution company]

[IFRS 15:IE307 & IE308, Example 60]

An entity, a movie distribution company, licenses Movie XYZ to a customer. The customer, an operator of cinemas, has the right to show the movie in its cinemas for six weeks. Additionally, the entity has agreed to (a) provide memorabilia from the filming to the customer for display at the customer's cinemas before the beginning of the six-week screening period; and (b) sponsor radio advertisements for Movie XYZ on popular radio stations in the customer's geographical area throughout the six-week screening period. In exchange for providing the licence and the additional promotional goods and services, the entity will receive a portion of the operator's ticket sales for Movie XYZ (ie variable consideration in the form of a sales-based royalty).

The entity concludes that the licence to show Movie XYZ is the predominant item to which the sales-based royalty relates because the entity has a reasonable expectation that the customer would ascribe significantly more value to the licence than to the related promotional goods or services. The entity recognises revenue from the sales-based royalty, the only consideration to which the entity is entitled under the contract, wholly in accordance with [IFRS 15:B63]. If the licence, the memorabilia and the advertising activities are separate performance obligations, the entity would allocate the sales-based royalty to each performance obligation.

Example 11.3.3E

Access to intellectual property [sports team logo]

[IFRS 15:IE309 – IE313, Example 61]

An entity, a well-known sports team, licenses the use of its name and logo to a customer. The customer, an apparel designer, has the right to use the sports team's name and logo on items including t-shirts, caps, mugs and towels for one year. In exchange for providing the licence, the entity will receive fixed consideration of CU2 million and a royalty of five per cent of the sales price of any items using the team name or logo. The customer expects that the entity will continue to play games and provide a competitive team.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with [IFRS 15:27 (see 6.2.1)]. The entity concludes that its only performance obligation is to transfer the licence. The additional activities associated with the licence (ie continuing to play games and provide a competitive team) do not directly transfer a good or service to the customer because they are part of the entity's promise to grant the licence.

The entity assesses the nature of the entity's promise to transfer the licence in accordance with [IFRS 15:B58 (see 11.2.2)]. In assessing the criteria the entity considers the following:

- (a) the entity concludes that the customer would reasonably expect that the entity will undertake activities that will significantly affect the intellectual property (ie the team name and logo) to which the customer has rights. This is on the basis of the entity's customary business practice to undertake activities that support and maintain the value of the name and logo such as continuing to play and providing a competitive team. The entity determines that the ability of the customer to obtain benefit from the name and logo is substantially derived from, or dependent upon, the expected activities of the entity. In addition, the entity observes that because some of its consideration is dependent on the success of the customer (through the sales-based royalty), the entity has a shared economic interest with the customer, which indicates that the customer will expect the entity to undertake those activities to maximise earnings.



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- (b) the entity observes that the rights granted by the licence (ie the use of the team's name and logo) directly expose the customer to any positive or negative effects of the entity's activities.
- (c) the entity also observes that even though the customer may benefit from the activities through the rights granted by the licence, they do not transfer a good or service to the customer as those activities occur.

The entity concludes that the criteria in [IFRS 15:B58] are met and the nature of the entity's promise to grant the licence is to provide the customer with access to the entity's intellectual property as it exists throughout the licence period. Consequently, the entity accounts for the promised licence as a performance obligation satisfied over time (ie the criterion in [IFRS 15:35(a)] (see 9.2.1) is met).

The entity then applies [IFRS 15:39 to 45] (see 9.3.1) to determine a measure of progress that will depict the entity's performance. For the consideration that is in the form of a sales-based royalty, [IFRS 15:B63] applies because the sales-based royalty relates solely to the licence, which is the only performance obligation in the contract. The entity concludes that recognition of the CU2 million fixed consideration as revenue rateably over time plus recognition of the royalty as revenue as and when the customer's sales of items using the team name or logo occur reasonably depicts the entity's progress towards complete satisfaction of the licence performance obligation.

11.3.4 Recognition of sales-based royalties – information received from the licensee after the end of the reporting period

Example 11.3.4

Recognition of sales-based royalties – information received from the licensee after the end of the reporting period

Entity A enters into a software licence with Entity B that allows inclusion of the software in computers that Entity B sells to third parties. Under the terms of the licence, Entity A receives royalties on the basis of the number of computers sold that include the licensed software.

Upon delivery of the software to Entity B, Entity A satisfied the performance obligation to which the sales-based royalties were allocated. Thereafter, Entity A receives quarterly sales data in arrears, which allows it to calculate the royalty payments due under the licence.

Should Entity A recognise revenue (royalty payments) for computer sales made by Entity B up to the end of its reporting period even though sales data had not been received at the end of that reporting period?

Yes. Provided that the related performance obligation has been satisfied (as is the case in this example), IFRS 15:B63 requires that sales-based royalties received for a licence of intellectual property be recognised when the subsequent sale or usage by the licensee occurs. It would not be appropriate to delay recognition until the sales information is received.

In the circumstances described, royalties should be recognised for sales made by Entity B up to the end of Entity A's reporting period on the basis of sales data received before Entity A's financial statements are authorised for issue (the receipt of such data constitutes an adjusting event in accordance with IAS 10 *Events After the Reporting Period*). If necessary, Entity A should estimate sales made in any period not covered by such data. It would not be appropriate for entities to omit sales-based royalties from financial statements merely because the associated sales data were received after the end of the reporting period or had not been received when the financial statements were authorised for issue.



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11.3.5 Fixed royalty payments for a licence of intellectual property receivable on reaching sales-based or usage-based milestones

In many industries it is common for contracts relating to a licence of intellectual property to include payment terms tied to milestones ('milestone payments'). These milestone payments are frequently structured such that entitlement to or payment of an amount specified in the contract is triggered once a sales target (i.e. specified level of sales) has been reached (e.g. a CU10 million milestone payment is triggered once cumulative sales by the licensee exceed CU100 million).

Revenue in respect of such milestone payments should be recognised when the sales- or usage-based milestone is reached (or later if the related performance obligation has not been satisfied), as required by the exception for sales- or usage-based royalties set out in IFRS 15:B63 (see **11.3.1**). This requirement applies to milestone payments triggered by reference to sales- or usage-based thresholds even when the milestone amount to be paid is fixed.

However, this exception should not be applied to milestone payments related to the occurrence of any other event or indicator (e.g. regulatory approval or proceeding into a beta phase of testing).

IFRS 15:BC415 states that "[t]he [IASB and FASB] decided that for a licence of intellectual property for which the consideration is based on the customer's subsequent sales or usage, an entity should not recognise any revenue for the variable amounts until the uncertainty is resolved (ie when a customer's subsequent sales or usage occurs)". This paragraph illustrates the boards' intent that the exception should apply to consideration only when it is (1) related to licences of intellectual property, and (2) based on the customer's subsequent sales or usage.

11.3.6 Guaranteed minimum sales- or usage-based royalties payable for 'right-to-use' licences of intellectual property

A licence of intellectual property ('IP') which has been determined to be a 'right-to-use' licence in accordance with IFRS 15:B56(b) (and, consequently, for which control transfers at a point in time – see **11.2.1**) may include sales- or usage-based royalties for any sales or usage, subject to a minimum guaranteed amount which establishes a floor for the amount of consideration.

When the transaction price for such a right-to-use licence includes a minimum guarantee, an entity should recognise the minimum guaranteed amount as revenue at the point in time that the entity transfers control of the licence to the customer. This is because the minimum guarantee is not dependent on future sales or usage of the underlying IP and, accordingly, it is not subject to the recognition constraint in IFRS 15:B63 (see **11.3.1**). Any royalties that exceed the minimum guaranteed amount should be recognised as the subsequent sales or usage relating to the IP occurs, in accordance with IFRS 15:B63.

This issue was discussed by the FASB Transition Resource Group for Revenue Recognition in the context of FASB Accounting Standards Codification (ASC) Topic 606 (the US GAAP equivalent of IFRS 15).



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Example 11.3.6

Guaranteed minimum royalties payable for right-to-use licences of intellectual property

Entity X enters into a contract with a customer, providing the customer with a licence to air all of the existing seasons of a long-running TV show. Entity X determines that the licence granted to the customer represents a 'right-to-use' licence in accordance with IFRS 15:B56(b).

The transaction price is as follows:

- CU1,000 payable each time an episode of the TV show is aired by the customer (representing a usage-based royalty in accordance with IFRS 15:B63); and
- a minimum guarantee of CU500,000 per year over the five years of the contract.

Ignoring the potential effects of financing (for simplicity), Entity X should recognise the total minimum guarantee of CU2.5 million (CU500,000 x5) for the contract when control of the licence is transferred to the customer and the licence period begins. Entity X should then recognise a further CU1,000 each time the customer airs an episode of the TV show after the minimum guarantee is reached in any year (i.e. each time an episode is shown after the first 500 episodes have been aired in each year of the five-year term).

11.3.7 Guaranteed minimum sales- or usage-based royalties payable for 'right-to-access' licences of intellectual property

A licence of IP which has been determined to be a 'right-to-access' licence in accordance with IFRS 15:B56(a) (and, consequently, for which control transfers over time – see 11.2.1) may include both sales- or usage-based royalties for any sales or usage, subject to a minimum guaranteed amount which establishes a floor for the amount of consideration.

When the transaction price for such a right-to-access licence includes a minimum guarantee, an entity should determine a method that appropriately depicts its progress toward completion. Depending on the facts and circumstances, the following methods may be acceptable approaches for recognising revenue under IFRS 15 for such arrangements.

- The entity recognises revenue as the sales or usage occurs in accordance with IFRS 15:39 (see 9.3.1.1). This approach would be appropriate only if the estimated sales- or usage-based royalties are expected to exceed the minimum guarantee. This approach is illustrated in **example 11.3.7A**.
- The entity estimates the transaction price (as the fixed consideration plus expected additional royalties to be earned over the licence term) and recognises revenue over time by using an appropriate measure of progress (e.g. time elapsed) in accordance with IFRS 15:39. Under this approach, cumulative revenue recognised should be limited to the cumulative royalties once the minimum guarantee has been recognised as revenue. As with the first approach above, this approach would be appropriate only if the estimated sales- or usage-based royalties are expected to exceed the minimum guarantee. Under this approach, an entity will need to periodically revisit its estimate of the total consideration (fixed and variable) and update its measure of progress accordingly. This approach is illustrated in **example 11.3.7B**.
- The entity recognises the minimum guarantee over time by using an appropriate measure of progress over the licence period in accordance with IFRS 15:39, and recognises incremental royalties in excess of the minimum guarantee as the subsequent sales or usage related to those incremental royalties occurs. This approach is illustrated in **example 11.3.7C**.



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Depending on facts and circumstances, other methods may be acceptable.

In addition, entities should consider providing appropriate disclosures to help users of their financial statements understand which approach is being applied. Examples of such disclosures include the key judgements the entity applied in selecting a measure of progress for recognising revenue from a right-to-access licence of IP.

This issue was discussed by the FASB Transition Resource Group for Revenue Recognition in the context of FASB Accounting Standards Codification (ASC) Topic 606 (the US GAAP equivalent of IFRS 15).

Example 11.3.7A
Guaranteed minimum royalties payable for right-to-access licences of intellectual property – method 1

Entity X enters into a five-year contract with a customer to license a trademark. The licence of the trademark is determined to represent a right-to-access licence of IP and, consequently, revenue will be recognised over time. The contract requires the customer to pay sales-based royalties of 5 per cent of the customer’s gross sales associated with the trademark. The contract also includes a guarantee that Entity X will receive a minimum of CU5 million for the entire five-year period.

Entity X’s expectation of the customer’s gross sales associated with the trademark and the related royalties for each year of the contract is as follows.

Year	Estimated gross sales CU’000	Associated royalties (5% of estimated gross sales) CU’000
1	15,000	750
2	30,000	1,500
3	40,000	2,000
4	20,000	1,000
5	60,000	3,000
Total expected royalties		8,250

Entity X therefore expects that total royalties received under the contract (CU8.25 million) will exceed the guaranteed fixed minimum (CU5 million).

Entity X recognises revenue as the underlying sales occur. Entity X determines that an output method of progress based on underlying sales is an appropriate method of progress as the royalties due (and invoiced) each year correlate directly with the value to the customer of its performance to date (see 9.3.3.2). Because the expected minimum guarantee of CU5 million is expected to be exceeded, the guarantee has no impact on revenue recognition for this selected method of progress.

Entity X also determines the selected method of progress complies with the recognition constraint for sales- or usage-based royalties in IFRS 15:B63 because revenue is not recognised until the underlying sales occur.

Entity X therefore recognises revenue over the five-year contract term as follows.



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Year	Royalties received	Cumulative royalties received	Annual revenue under IFRS 15	Cumulative revenue under IFRS 15
	CU 000	CU'000	CU'000	CU'000
1	750	750	750	750
2	1,500	2,250	1,500	2,250
3	2,000	4,250	2,000	4,250
4	1,000	5,250	1,000	5,250
5	3,000	8,250	3,000	8,250
Total	8,250		8,250	

Example 11.3.7B

Guaranteed minimum royalties payable for right-to-access licences of intellectual property – method 2

The facts are the same as in [example 11.3.7A](#).

Entity X uses an estimation of the total transaction price of CU8.25 million (comprising CU5 million fixed consideration and CU3.25 million of variable consideration) and recognises revenue over the five-year term using time elapsed as its measure of progress towards complete satisfaction of its performance obligation under the contract. In doing so, the cumulative revenue recognised cannot exceed the cumulative royalties once the minimum guarantee of CU5 million has been recognised as revenue.

Entity X therefore recognises revenue over the five-year contract term as follows.

Year	Royalties received	Cumulative royalties received	Annual revenue under IFRS 15	Cumulative revenue under IFRS 15
	CU'000	CU'000	CU'000	CU'000
1	750	750	1,650	1,650
2	1,500	2,250	1,650	3,300
3	2,000	4,250	1,650	4,950
4	1,000	5,250	300	5,250
5	3,000	8,250	3,000	8,250
Total	8,250		8,250	

In Years 1 to 3, annual revenue of CU1.65 million (i.e. CU8.25million/5 years) is recognised based on straight-line recognition of the total estimated transaction price of CU8.25 million over the five-year term. At the end of Year 3, while the cumulative royalties received are only CU4.25 million, Entity X is entitled to recognise cumulative revenue of CU4.95 million because this does not exceed the CU5 million fixed consideration.

In Year 4, Entity X is only entitled to recognise revenue of CU0.3 million because the cumulative revenue is constrained to CU5.25 million, representing the total royalties received as at the end of Year 4. This is because, once the minimum guarantee of CU5 million has been recognised as revenue, the remaining consideration received is variable and subject to the restriction in IFRS 15:B63 where sales-based royalties cannot be recognised until the subsequent sale has occurred.



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Example 11.3.7C
Guaranteed minimum royalties payable for right-to-access licences of intellectual property – method 3

The facts are the same as in **example 11.3.7A**.

Entity X determines that the recognition constraint in IFRS 15:B63 precludes the recognition of any amounts of variable consideration (i.e. the estimated CU3.25 million) until the cumulative royalties received exceed the minimum guarantee of CU5 million (i.e. the fixed consideration under the contract). Entity X therefore applies a time elapsed method of progress to the CU5 million fixed consideration (i.e. CU1 million a year) until the point that the cumulative royalties received exceed CU5 million. Entity X considers the licence to represent a series of distinct goods or services over the five years (see **6.1.1**) and the variable consideration under the contract (i.e. the royalties in excess of the minimum guarantee) is therefore allocated to the distinct time periods to which it relates once cumulative royalties exceed CU5 million (see **8.5**).

Entity X therefore recognises revenue over the five-year contract term as follows.

Year	Royalties received	Cumulative royalties received	Annual revenue under IFRS 15	Cumulative revenue under IFRS 15
	CU'000	CU'000	CU'000	CU'000
1	750	750	1,000	1,000
2	1,500	2,250	1,000	2,000
3	2,000	4,250	1,000	3,000
4	1,000	5,250	1,250	4,250
5	3,000	8,250	4,000	8,250
Total	8,250		8,250	

In Years 1 to 3 Entity X only, recognises the CU1 million a year which is the fixed consideration of CU5 million spread pro rata over the five years of the contract. Entity X does not recognise any of the variable consideration in Years 1 to 3 because the cumulative royalties received as at the end of Year 3 are less than the minimum guaranteed revenue of CU5 million. In Year 4, cumulative royalties received are CU5.25 million and the variable consideration of CU0.25 million (CU5.25 million less the fixed consideration of CU5 million) is allocated to Year 4 because that is the time period in which the related sales of the customer occurred. In Year 5, the entity recognises CU1 million from the minimum guarantee and the CU3 million in variable consideration representing the difference between CU8.25 million and CU5.25 million.



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Section 12. Contract costs

12.1 Contract costs – general

IFRS 15 introduces guidance on how to account for costs associated with a contract with a customer when they do not fall within the scope of another Standard. It distinguishes between:

- costs of obtaining a contract (see **12.2**); and
- costs of fulfilling a contract (see **12.3**).

When considering how to account for costs that are incurred before a contract exists (i.e. pre-contract costs), it is important to keep in mind that they may include both costs of obtaining a contract and costs of fulfilling a contract, and that the requirements in respect of each are different. In particular, IFRS 15:95 (see **12.3.1**) makes clear that, in some circumstances, it may be appropriate to recognise an asset for costs incurred to fulfil a contract that does not yet exist (i.e. a specific anticipated contract).

12.2 Costs of obtaining a contract

12.2.1 Costs of obtaining a contract – general

Costs to obtain a contract that would have been incurred irrespective of whether the contract was obtained are recognised as an expense when incurred, unless those costs are explicitly chargeable to the customer irrespective of whether the contract is obtained. [IFRS 15:93]

The incremental costs of obtaining a contract with a customer are recognised as an asset if the entity expects to recover those costs. [IFRS 15:91] Those incremental costs are costs incurred to obtain a contract with a customer that would not have been incurred if the contract had not been obtained. [IFRS 15:92]

Therefore, costs incurred in the effort to obtain a contract (e.g. the costs of preparing a proposal) that are payable irrespective of whether the effort is successful cannot be capitalised – they do not qualify as ‘incremental costs’ for the purposes of IFRS 15. Only costs that would not have been incurred if the effort was not successful (e.g. a sales commission) are recognised as an asset.

TRG

IFRS 15:91 does not specify at what point in time the incremental costs of obtaining a contract should be recognised. The timing of such recognition may not be straightforward, in particular when the arrangements for payment of the incremental costs are complex (e.g. payment of a sales commission may be contingent on a future event, subject to clawback, or based on achieving cumulative targets).

The timing for recognition of the incremental costs of obtaining a contract (either as an asset in accordance with IFRS 15:91, if the costs are expected to be recovered, or as an expense) will be determined under other IFRSs (e.g. IAS 37 Provisions, Contingent Liabilities and Contingent Assets, IAS 19 Employee Benefits (see **12.2.2**) or IFRS 2 Share-based Payment), which specify when a liability for the costs should be recognised and how that liability should be measured.

At the same point in time as a liability is recognised under the relevant Standard, IFRS 15:91 should be applied to determine whether those recognised costs should be capitalised as an asset or recognised immediately as an expense.



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If the amortisation period (see 12.4.1) of the asset resulting from the incremental costs would be one year or less, IFRS 15 provides a practical expedient whereby those costs can be expensed when incurred. [IFRS 15:94]

Entities should not apply the practical expedient if the amortisation period is greater than one year.

Example 12.2.1

Incremental costs of obtaining a contract

[IFRS 15:IE189 – IE191, Example 36]

An entity, a provider of consulting services, wins a competitive bid to provide consulting services to a new customer. The entity incurred the following costs to obtain the contract:

	CU
External legal fees for due diligence	15,000
Travel costs to deliver proposal	25,000
Commissions to sales employees	10,000
Total costs incurred	50,000

In accordance with [IFRS 15:91], the entity recognises an asset for the CU10,000 incremental costs of obtaining the contract arising from the commissions to sales employees because the entity expects to recover those costs through future fees for the consulting services. The entity also pays discretionary annual bonuses to sales supervisors based on annual sales targets, overall profitability of the entity and individual performance evaluations. In accordance with [IFRS 15:91], 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 [IFRS 15:93], 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.



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12.2.2 Capitalising employee benefits

TRG

An entity that sponsors a defined contribution post-employment benefit plan may make contributions determined as a percentage of salaries paid to sales representatives which include sales commissions. When the sales commissions are determined to meet the definition of incremental costs of obtaining contracts with customers in IFRS 15:92, and are therefore capitalised in accordance with IFRS 15:91 (see **12.2.1**), the incremental defined contribution plan payments (along with other employee benefits) that arise directly as a result of sales commissions also qualify as incremental costs of obtaining the contracts. However, incremental costs of obtaining contracts with customers would not include employee benefits that are directly related to costs that would have been incurred regardless of whether a contract with a customer had been obtained (e.g. employee benefits that are based on a percentage of an employee's fixed salary independent of obtaining contracts with customers).

This issue was discussed by the TRG and subsequently discussed by the FASB Transition Resource Group for Revenue Recognition in the context of FASB Accounting Standards Codification (ASC) Topic 606 (the US GAAP equivalent of IFRS 15).

12.3 Costs of fulfilling a contract

12.3.1 Costs of fulfilling a contract – general

If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (e.g. IAS 2 Inventories, IAS 16 Property, Plant and Equipment or IAS 38 Intangible Assets), an asset is recognised for the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

[IFRS 15:95]

- (a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (e.g. costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);
- (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.

When costs incurred in fulfilling a contract with a customer are within the scope of other Standards, they are accounted for in accordance with those other Standards. [IFRS 15:96]

Accordingly, if costs are within the scope of another Standard, and that Standard requires them to be expensed, it is not appropriate to argue that they should be capitalised in accordance with IFRS 15.

Costs that relate directly to a contract (or a specific anticipated contract) include any of the following:

[IFRS 15:97]

- (a) direct labour (e.g. salaries and wages of employees who provide the promised services directly to the customer);
- (b) direct materials (e.g. supplies used in providing the promised services to a customer);
- (c) allocations of costs that relate directly to the contract or to contract activities. Such costs might include, for example:
 - costs of contract management and supervision; and
 - insurance and depreciation of tools, equipment and, for entities that have adopted IFRS 16 *Leases* (effective for annual periods beginning on or after 1 January 2019, with earlier application permitted) right-of-use assets used in fulfilling the contract;



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- (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 (e.g. payments to subcontractors).

An entity recognises the following costs as expenses when incurred:

[IFRS 15:98]

- (a) general and administrative costs (unless those costs are explicitly chargeable to the customer under the contract, as per IFRS 15:97(d));
- (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 (i.e. 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).

Example 12.2.1

Costs that give rise to an asset

[IFRS 15:IE192 – IE196, Example 37]

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 [IFRS 15:91], 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 [IFRS 15:99], because the asset relates to the services transferred to the customer during the contract term of five years and the entity anticipates that the contract will be renewed for two subsequent one-year periods.

Costs to fulfil a contract

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

	CU
Design services	40,000
Hardware	120,000
Software	90,000
Migration and testing of data centre	100,000
Total costs	350,000



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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 [IFRS 15:95] 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 [IFRS 15:95(b)]). Therefore, the costs do not meet the criteria in [IFRS 15:95] and cannot be recognised as an asset using IFRS 15. In accordance with [IFRS 15:98], the entity recognises the payroll expense for these two employees when incurred.

12.3.2 Costs recognised as an asset when contract is satisfied over time

Example 12.3.2

Costs recognised as an asset when contract is satisfied over time

Entity X has entered into a contract that consists of a single performance obligation satisfied over time. The transaction price is CU1,250, and the expected costs of fulfilling the contract are CU1,000, resulting in an expected overall margin of 20 per cent. Entity X has decided that it is appropriate to use an output method to measure its progress towards completion of the performance obligation.

At the reporting date, Entity X has incurred cumulative fulfilment costs of CU360, all of which relate to performance completed to date. Using the output measure of progress, Entity X determines that revenue in respect of performance to date should be measured at CU405, resulting in a margin of approximately 11.1 per cent for the work performed to date. The total expected costs of fulfilling the contract remain at CU1,000.

Although the contract consists of a single performance obligation, and the margin expected on the contract is 20 per cent, Entity X cannot recognise an asset/defer costs of CU36 in order to adjust the margin on work performed to date to 20 per cent. IFRS 15:98 lists certain costs incurred in fulfilling the contract that must be expensed when incurred, which include “costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (ie costs that relate to past performance)” (see 12.3.1). Therefore, all of the costs of CU360 incurred by Entity X should be expensed because they relate to performance completed to date.

As noted in IFRS 15:39, the measure of progress used to recognise revenue for performance obligations satisfied over time is intended to depict the goods or services for which control has already transferred to the customer (see 9.3.1.1). Recognising an asset (e.g. work in progress) for costs of past performance would be inconsistent with the notion that control of the goods or services is transferred to the customer over time (i.e. as performance occurs).



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If any costs had been incurred that related to future performance (e.g. inventories and other assets that have not yet been used in the contract and are still controlled by the seller), those should be recognised as assets if they met the conditions in the relevant Standard (e.g. IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets*) or, if the costs are not within the scope of another Standard, if they met all of the criteria in IFRS 15:95.

Also, note that if Entity X had decided that it was appropriate to use cost as a measure of progress, it would determine that the performance obligation is 36 per cent complete ($CU360 \div CU1,000$). Accordingly, it would recognise revenue of CU450 (36 per cent \times CU1,250), thus reflecting a margin of 20 per cent.

12.3.3 Initial sales made at a loss in the expectation of generating future profitable sales

Example 12.3.3

Initial sales made at a loss in the expectation of generating future profitable sales

Entity E's business model includes the sale of equipment and parts that are needed to maintain that equipment. It is possible for customers to source parts from other suppliers, but the regulatory environment in which Entity E's customers operate is such that in almost all cases they will choose to purchase parts from Entity E (the original equipment manufacturer). The spare parts are needed for the equipment to properly function for its expected economic life.

According to its business model, when Entity E believes it will likely secure a profitable stream of parts sales, it sells the equipment at a significantly discounted price (less than the cost to manufacture the equipment). This initial contract is for the equipment only; it does not provide Entity E with a contractual right to insist that the customer subsequently purchase parts (see 6.1.3). However, in all cases Entity E's experience has been that the customer has subsequently purchased parts, and the profits on those parts sales have more than compensated for the discount given on the equipment.

The equipment has a cost of CU200 and would usually be sold for a profit. However, the equipment is sold at a discounted price of CU150 if subsequent parts sales are expected.

When the equipment is sold for CU150, Entity E is not permitted to defer an element of the cost of CU200 to reflect its expectation that this sale will generate further, profitable sales in the future. IFRS 15:95 and 96 require that, when the costs of fulfilling a contract are in the scope of another Standard, they should be accounted for in accordance with that Standard (see 12.3.1). In the circumstances described, the costs of CU200 are in the scope of IAS 2 *Inventories* and should be expensed when the equipment is sold in accordance with IAS 2:34. IFRS 15:98(c) clarifies this further, including a specific requirement that "costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (ie costs that relate to past performance)" should be expensed when incurred.

Although Entity E expects the customer to purchase additional parts that will give rise to future profits, those additional purchases are at the customer's option and are not part of the contract to sell the equipment. Entity E has satisfied its obligation to deliver the equipment and, as such, is required to recognise CU150 revenue and CU200 cost in full.

Consequently, a loss of CU50 arises on the initial sale of the equipment.



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12.4 Amortisation and impairment of contract costs

12.4.1 Amortisation of capitalised contract costs

An asset recognised in respect of a cost of obtaining or fulfilling a contract should be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

The asset may relate to goods or services to be transferred under a specific anticipated contract (as described in IFRS 15:95(a) – see **12.3.1**). [IFRS 15:99]

12.4.2 Amortisation method for capitalised contract costs

IFRS 15 does not provide specific guidance on the method an entity should use to amortise these assets. Amortisation of capitalised costs on a 'systematic basis' should take into account the expected timing of transfer of the goods and services related to the asset (which typically corresponds to the period and pattern in which revenue will be recognised in the financial statements). The pattern in which the related revenue is recognised could be significantly front-loaded, back-loaded or seasonal, and costs should be amortised accordingly.

To determine the pattern of transfer, entities may need to analyse the specific terms of each arrangement. In determining the appropriate amortisation method, they should consider all relevant factors including:

- experience with, and ability to reasonably estimate, the pattern of transfer; and
- the timing of the transfer of control of the goods or services to the customer.

In some situations, more than one amortisation method may be acceptable if this reasonably approximates the expected period and pattern of transfer of goods and services. However, an amortisation method is unacceptable if it is not expected to reflect the period and pattern of such transfer. When entities select a method, they should apply it consistently to similar contracts. If there is no evidence to suggest that a specific pattern of transfer can be expected, a straight-line amortisation method may be appropriate.

If the pattern in which contractual goods or services are transferred over the contract term varies significantly each period, it may be appropriate to use an amortisation model that more closely aligns with the variations in the transfer pattern. For example, amortisation could be allocated to the periods on the basis of the proportion of the total goods or services transferred each period. If the cost is related to goods or services transferred at a point in time, it follows that the amortised cost should be recognised at the same point in time.

When an entity's customer has been granted a material right to acquire future goods or services, and revenue related to the material right is being deferred, an entity should consider whether it would be appropriate to allocate to that right a portion of the costs that are capitalised in accordance with IFRS 15:91 or IFRS 15:95.

The amortisation is updated to reflect a significant change in the entity's expected timing of transfer to the customer of the goods or services to which the asset relates. Any change is accounted for as a change in accounting estimate in accordance with IAS 8. [IFRS 15:100]



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12.4.3 Amortisation period for capitalised contract costs

As illustrated in **example 12.3.1**, the amortisation period for capitalised contract costs should include optional extension periods if the entity expects to continue to provide services during those periods.

For example, an entity enters into a service contract with a customer and incurs incremental costs to obtain the contract and costs to fulfil the contract. These costs are capitalised as assets in accordance with IFRS 15:91 and IFRS 15:95, respectively. The initial term of the contract is five years, but it can be renewed for subsequent one-year periods up to a maximum of 10 years. The average contract term for similar contracts entered into by the entity is seven years. The most appropriate amortisation period is likely to be seven years (i.e. the initial term of five years plus two anticipated one-year renewals) because that is the period over which the entity expects to provide services under the contract to which the capitalised costs relate.

12.4.4 Impairment of contract costs

An impairment loss is recognised in profit or loss to the extent that the carrying amount of an asset recognised in respect of costs of obtaining or fulfilling a contract exceeds: [IFRS 15:101]

- (a) the remaining amount of consideration that the entity expects to receive in exchange for the goods or services to which the asset relates; less
- (b) the costs that relate directly to providing those goods or services (see **12.3.1**) and that have not been recognised as expenses.

TRG

For the purposes of IFRS 15:101(a), the entity should consider the economic benefits (estimated future cash flows) from anticipated contract extensions or renewals if the contract cost asset relates, in part, to goods or services that are expected to be transferred during those extension or renewal periods. For example, an entity enters into a service contract with a customer and incurs incremental costs to obtain the contract and costs to fulfil the contract. These costs are capitalised as assets in accordance with IFRS 15:91 and IFRS 15:95, respectively. The initial term of the contract is five years, but it can be renewed for subsequent one-year periods up to a maximum of 10 years. The average contract term for similar contracts entered into by the entity is seven years. The 'remaining amount of consideration' should be based on the expected contract term of seven years (i.e. consistent with the amortisation period, see **12.4.3**).

Although this approach may result in the entity considering cash flows that are too uncertain to include in the recognition of revenue, it is not inappropriate to do so because the objective for measuring and recognising impairments in this context (i.e. to determine whether the asset is recoverable) is different from the measurement objective for revenue. [IFRS 15:BC310] This issue was discussed by the TRG in July 2014.



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When applying IFRS 15:101 to determine the amount of consideration that an entity expects to receive, the principles for determining the transaction price (except for the requirements for constraining estimates of variable consideration – see **7.2.8**) should be considered and adjusted to reflect the effects of the customer's credit risk. [IFRS 15:102]

Any impairment losses for assets related to the contract recognised in accordance with another Standard (e.g. IAS 2, IAS 16 and IAS 38) should be recognised before an entity recognises an impairment loss for an asset recognised in respect of a cost of obtaining or fulfilling a contract. After applying the impairment test in IFRS 15:101, an entity should include the resulting carrying amount of the asset recognised in respect of a cost of obtaining or fulfilling a contract in the carrying amount of the cash-generating unit to which the asset belongs for the purpose of applying IAS 36 *Impairment of Assets* to that cash-generating unit. [IFRS 15:103]

A reversal of some or all of an impairment loss previously recognised in accordance with IFRS 15:101 is recognised in profit or loss when the impairment conditions no longer exist or have improved. The increased carrying amount of the asset cannot exceed the amount that would have been determined (net of amortisation) if no impairment loss had been recognised previously. [IFRS 15:104]

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Section 13. Presentation of contract assets and contract liabilities

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Section 13. Presentation of contract assets and contract liabilities

13.1 Presentation of contract assets and contract liabilities – general

When either party to a contract has performed, an entity is required to present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. Any unconditional rights to consideration are presented separately as a receivable. [IFRS 15:105]

A contract liability arises if a customer pays consideration, or if the entity has a right to consideration that is unconditional (i.e. a receivable), before the good or service is transferred to the customer. The liability should be recognised either when the payment is made or when the payment is due (whichever is earlier). The contract liability represents the obligation to transfer goods or services to a customer for which consideration has been received (or an amount of consideration is due) from the customer. [IFRS 15:106]

A contract asset arises if an entity performs by transferring goods or services to a customer before the consideration is paid or before payment is due. The balance excludes any amounts presented as a receivable. The contract asset represents the right to consideration in exchange for goods or services that have been transferred to a customer. The asset should be assessed for impairment in accordance with IFRS 9 *Financial Instruments* (or, for entities that have not yet adopted IFRS 9, IAS 39 *Financial Instruments: Recognition and Measurement*) and, when relevant, the impairment is measured, presented and disclosed on the same basis as a financial asset that is within the scope of IFRS 9 (or IAS 39) (see also **14.2**). [IFRS 15:107]

A receivable is a right to consideration that is unconditional, i.e. only the passage of time is required before payment of that consideration is due. For example, a receivable will be recognised if the entity has a present right to payment even though that amount may be subject to refund in the future. The receivable should be accounted for in accordance with IFRS 9 (or IAS 39). At initial recognition of the receivable, any difference between the measurement of the receivable in accordance with IFRS 9 (or IAS 39) and the corresponding amount of revenue recognised should be presented as an expense (e.g. as an impairment loss). [IFRS 15:108]

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. If an alternative description is used for a contract asset, sufficient information should be provided to enable a user of the financial statements to distinguish between receivables and contract assets. [IFRS 15:109]

IFRS 15 provides the following examples, which illustrate how contract assets, contract liabilities and receivables should be considered in relation to each other.



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Example 13.1A**Contract liability and receivable**

[IFRS 15:IE198 – IE200, Example 38]

Case A – Cancellable contract

On 1 January 20X9, an entity enters into a cancellable contract to transfer a product to a customer on 31 March 20X9. The contract requires the customer to pay consideration of CU1,000 in advance on 31 January 20X9. The customer pays the consideration on 1 March 20X9. The entity transfers the product on 31 March 20X9. The following journal entries illustrate how the entity accounts for the contract:

(a) the entity receives cash of CU1,000 on 1 March 20X9 (cash is received in advance of performance):

Cash	CU 1,000	
Contract liability		CU 1,000

(b) the entity satisfies the performance obligation on 31 March 20X9:

Contract liability	CU 1,000	
Revenue		CU 1,000

Case B – Non-cancellable contract

The same facts as in Case A apply to Case B except that the contract is non-cancellable. The following journal entries illustrate how the entity accounts for the contract:

(a) the amount of consideration is due on 31 January 20X9 (which is when the entity recognises a receivable because it has an unconditional right to consideration):

Receivable	CU 1,000	
Contract liability		CU 1,000

(b) the entity receives the cash on 1 March 20X9:

Cash	CU 1,000	
Receivable		CU 1,000

(c) the entity satisfies the performance obligation on 31 March 20X9:

Contract liability	CU 1,000	
Revenue		CU 1,000

If the entity issued the invoice before 31 January 20X9 (the due date of the consideration), the entity would not present the receivable and the contract liability on a gross basis in the statement of financial position because the entity does not yet have a right to consideration that is unconditional.


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Example 13.1B**Contract asset recognised for the entity's performance**

[IFRS 15:IE201 – IE204, Example 39]

On 1 January 20X8, an entity enters into a contract to transfer Products A and B to a customer in exchange for CU1,000. The contract requires Product A to be delivered first and states that payment for the delivery of Product A is conditional on the delivery of Product B. In other words, the consideration of CU1,000 is due only after the entity has transferred both Products A and B to the customer. Consequently, the entity does not have a right to consideration that is unconditional (a receivable) until both Products A and B are transferred to the customer.

The entity identifies the promises to transfer Products A and B as performance obligations and allocates CU400 to the performance obligation to transfer Product A and CU600 to the performance obligation to transfer Product B on the basis of their relative stand-alone selling prices. The entity recognises revenue for each respective performance obligation when control of the product transfers to the customer.

The entity satisfies the performance obligation to transfer Product A:

Contract asset	CU 400
Revenue	CU 400

The entity satisfies the performance obligation to transfer Product B and recognises the unconditional right to consideration:

Receivable	CU 1,000
Contract asset	CU 400
Revenue	CU 600


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Example 13.1C**Receivable recognised for the entity's performance**

[IFRS 15:IE205 – IE208, Example 40]

An entity enters into a contract with a customer on 1 January 20X9 to transfer products to the customer for CU150 per product. If the customer purchases more than 1 million products in a calendar year, the contract indicates that the price per unit is retrospectively reduced to CU125 per product.

Consideration is due when control of the products transfers to the customer. Therefore, the entity has an unconditional right to consideration (ie a receivable) for CU150 per product until the retrospective price reduction applies (ie after 1 million products are shipped).

In determining the transaction price, the entity concludes at contract inception that the customer will meet the 1 million products threshold and therefore estimates that the transaction price is CU125 per product. Consequently, upon the first shipment to the customer of 100 products the entity recognises the following:

Receivable	CU15,000^(a)
Revenue	CU12,500^(b)
Refund liability (contract liability)	CU2,500

^(a) CU150 per product × 100 products

^(b) CU125 transaction price per product × 100 products

The refund liability (see [IFRS 15:55]) represents a refund of CU25 per product, which is expected to be provided to the customer for the volume-based rebate (ie the difference between the CU150 price stated in the contract that the entity has an unconditional right to receive and the CU125 estimated transaction price).

13.2 Presentation of a contract as a single contract asset or contract liability**TRG**

When a contract (or multiple contracts accounted for as a single combined contract in accordance with IFRS 15:17) contains more than one performance obligation, it is possible that the aggregate of amounts already paid by the customer and unpaid amounts recognised as receivables is less than the revenue recognised for some performance obligations, but exceeds the revenue recognised for other performance obligations.

In such circumstances, an entity should not present separate contract assets (for those performance obligations for which the aggregate of amounts already paid by the customer and unpaid amounts recognised as receivables is less than the revenue recognised) and contract liabilities (when the converse applies). The appropriate unit of account for presenting contract assets and liabilities is the contract as a whole. Accordingly, it is not appropriate to present both contract assets and contract liabilities for a single contract; instead, a single net figure should be presented.

IFRS 15:105 states that, “[w]hen either party to a contract has performed, an entity shall present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity’s performance and the customer’s payment. An entity shall present any unconditional rights to consideration separately as a receivable”.

This also applies to circumstances in which multiple contracts are combined and are accounted for as a single contract in accordance with the requirements for combination in IFRS 15:17.

IFRS 15:BC317 explains that “[t]he boards decided that the remaining rights and performance obligations in a contract should be accounted for and presented on a net basis, as either a contract asset or a contract liability. The boards noted that the rights and obligations in a contract with a customer are interdependent. The boards decided that those interdependencies are best reflected by accounting and presenting on a net basis the remaining rights and obligations in the statement of financial position”. This issue was discussed by the TRG in October 2014.

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13.3 Offsetting contract assets and liabilities against other assets and liabilities

TRG

IFRS 15 introduces the terms 'contract asset' and 'contract liability' in the context of revenue arising from contracts with customers and provides guidance on the presentation of such assets and liabilities in the statement of financial position (see **14.2.3**).

Entities may also recognise other types of assets and liabilities which relate to customers, as a result of revenue or other transactions. Examples might include costs of obtaining a contract capitalised in accordance with IFRS 15:91, financial assets and financial liabilities as defined in paragraph 11 of IAS 32 *Financial Instruments: Presentation*, and provisions as defined in paragraph 10 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

In practice, it will not be possible for entities to offset other assets and liabilities against contract assets and liabilities. Paragraph 32 of IAS 1 *Presentation of Financial Statements* prohibits offsetting assets and liabilities unless required or permitted by an IFRS. Neither IFRS 15 nor any other IFRS includes such a requirement or permission in respect of contract assets and liabilities.

This issue was discussed by the TRG in October 2014, with general agreement that entities should refer to other IFRSs when determining whether to offset other assets and liabilities against contract assets and contract liabilities.

13.4 Presentation of contract assets and contract liabilities as current or non-current

Often contract assets and liabilities will be presented as current in the Statement of Financial Position. This is because they will be realised or settled in the entity's normal operating cycle (see IAS 1:66(a) for current assets and IAS 1:69(a) for current liabilities).

In other cases, it may be determined that a contract with a customer extends beyond the entity's normal operating cycle. In such cases, contract assets and contract liabilities should be analysed between current and non-current elements, by applying the guidance in IAS 1:66 and IAS 1:69, respectively.

An entity's normal operating cycle is assumed to be 12 months when not clearly identifiable (IAS 1:68).



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Section 14. Disclosure

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Section 14. Disclosure

14.1 Disclosure – general

The objective of the disclosure requirements in IFRS 15 is that sufficient information is disclosed 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 the objective, disclosure should be included of both qualitative and quantitative information about all of the following:

[IFRS 15:110]

- (a) its contracts with customers (see **14.2**);
- (b) the significant judgements, and changes in the judgements, made in applying IFRS 15 to those contracts (see **14.3**); and
- (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 **14.4**).

The level of detail necessary to satisfy the disclosure objective, and how much emphasis to place on each of the various requirements, will need to be considered. The disclosures presented should be aggregated or disaggregated in order that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have substantially different characteristics. [IFRS 15:111]

Information need not be disclosed in accordance with IFRS 15 if it has already been provided in accordance with another Standard. [IFRS 15:112]

IAS 8:8 states that accounting policies in IFRSs do not need to be applied when the effect of their application is not material. IAS 1:31 states that an entity need not provide a specific disclosure required by an IFRS if the information is not material. Entities should assess both quantitative and qualitative factors to determine the materiality of information about revenue from contracts with customers. This applies not only to recognition and measurement but also to disclosures in the financial statements.

This concept is reiterated by the requirement in paragraph IFRS 15:111 to “consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements” and by IFRS 15:BC331, which states as follows.

“The boards also decided to include disclosure requirements to help an entity meet the disclosure objective. However, those disclosures should not be viewed as a checklist of minimum disclosures, because some disclosures may be relevant for some entities or industries but may be irrelevant for others. The boards also observed that it is important for an entity to consider the disclosures together with the disclosure objective and materiality. Consequently, [IFRS 15:111] clarifies that an entity need not disclose information that is immaterial.”

This assessment should be made for each reporting period because a disclosure deemed to be irrelevant or immaterial in previous periods may subsequently become material as a result of increases in the monetary values to be disclosed or changes in other qualitative factors.

Entities should also consider the views of local regulators on the appropriate approach to assessing materiality in the context of disclosures.



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14.2 Contracts with customers

14.2.1 Disclosure of revenue and impairment losses

Disclosure is required of all of the following amounts for the reporting period unless those amounts are presented separately in the statement of comprehensive income in accordance with other Standards:

[IFRS 15:113]

- (a) revenue recognised from contracts with customers, which should be disclosed separately from other sources of revenue; and
- (b) any impairment losses recognised (in accordance with IFRS 9 *Financial Instruments* or, for entities that have not yet adopted IFRS 9, IAS 39 *Financial Instruments: Recognition and Measurement*) on any receivables or contract assets arising from an entity's contracts with customers, which should be disclosed separately from impairment losses from other contracts.

14.2.2 Disaggregation of revenue

Revenue recognised from contracts with customers should be disaggregated into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. [IFRS 15:114]

Consequently, the extent to which an entity's revenue is disaggregated for the purposes of this disclosure will depend 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 for disaggregating revenue. Other entities may meet the objective by using only one type of category to disaggregate revenue. [IFRS 15:B87]

When selecting the type of category (or categories) to use to disaggregate revenue, an entity should consider how information about the entity's revenue has been presented for other purposes, including:

[IFRS 15:B88]

- (a) disclosures presented outside the financial statements (e.g. in earnings releases, annual reports or investor presentations);
- (b) information regularly reviewed by the chief operating decision maker for evaluating the financial performance of operating segments; and
- (c) other information that is similar to the types of information identified in (a) and (b) above which 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.

Examples of categories that might be appropriate include:

[IFRS 15:B89]

- type of good or service (e.g. major product lines);
- geographical region (e.g. country or region);
- market or type of customer (e.g. government and non-government customers);
- type of contract (e.g. fixed-price and time-and-materials contracts);
- contract duration (e.g. short-term and long-term contracts);
- timing of transfer of goods or services (e.g. revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time); and
- sales channels (e.g. goods sold directly to consumers and goods sold through intermediaries).



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In addition, sufficient information should be disclosed to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue and revenue information that is disclosed for each reportable segment, if the entity applies IFRS 8 *Operating Segments*. [IFRS 15:115]

Example 14.2.2
Disaggregation of revenue – quantitative disclosures

[IFRS 15:IE210 & IE211, Example 41]

An entity reports the following segments: consumer products, transportation and energy, in accordance with IFRS 8 *Operating Segments*. When the entity prepares its investor presentations, it disaggregates revenue into primary geographical markets, major product lines and timing of revenue recognition (ie goods transferred at a point in time or services transferred over time).

The entity determines that the categories used in the investor presentations can be used to meet the objective of the disaggregation disclosure requirement in [IFRS 15:114], 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 [IFRS 15:115].

Segments	Consumer products	Transport	Energy	Total
	CU	CU	CU	CU
Primary geographical markets				
North America	990	2,250	5,250	8,490
Europe	300	750	1,000	2,050
Asia	700	260	–	960
	1,990	3,260	6,250	11,500
Major goods/service lines				
Office supplies	600	–	–	600
Appliances	990	–	–	990
Clothing	400	–	–	400
Motorcycles	–	500	–	500
Automobiles	–	2,760	–	2,760
Solar panels	–	–	1,000	1,000
Power plant	–	–	5,250	5,250
	1,990	3,260	6,250	11,500
Timing of revenue recognition				
Goods transferred at a point in time	1,990	3,260	1,000	6,250
Services transferred over time	–	–	5,250	5,250
	1,990	3,260	6,250	11,500



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14.2.3 Contract balances

An entity should disclose:

[IFRS 15:116]

- 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; and
- revenue recognised in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (e.g. changes in transaction price).

An entity should explain how the timing of satisfaction of its performance obligations relates to the typical timing of payment (see **14.2.4**) and the effect that those factors have on the contract asset and the contract liability balances. The explanation provided may use qualitative information. [IFRS 15:117]

An explanation should be provided of the significant changes in the contract asset and the contract liability balances during the reporting period, including both qualitative and quantitative information. Examples of changes in the entity's balances of contract assets and contract liabilities may include:

[IFRS 15:118]

- changes due to business combinations;
- cumulative catch-up adjustments to revenue which 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;
- impairment of a contract asset;
- a change in the time frame for a right to consideration to become unconditional (i.e. for a contract asset to be reclassified to a receivable); and
- a change in the time frame for a performance obligation to be satisfied (i.e. for the recognition of revenue arising from a contract liability).

14.2.4 Performance obligations

Information should be disclosed about an entity's performance obligations in contracts with customers, including a description of all of the following:

[IFRS 15:119]

- when the entity typically satisfies its performance obligations (e.g. 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 (e.g. 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 – see **7.2.8**);
- the nature of the goods or services that the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (i.e. if the entity is acting as an agent);
- obligations for returns, refunds and other similar obligations; and
- types of warranties and related obligations.



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14.2.5 Transaction price allocated to the remaining performance obligations

When an entity has performance obligations that it has not yet satisfied, it should disclose:

[IFRS 15:120]

- the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as at the end of the reporting period; and
- in relation to that amount, an explanation of when it expects to recognise the revenue, which it can disclose either:
 - on a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations; or
 - by using qualitative information.

IFRS 15 provides a practical expedient whereby this information does not need to be disclosed for a performance obligation where either:

[IFRS 15:121]

- (a) the performance obligation is part of a contract that originally was expected to have a duration of one year or less; or
- (b) the 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 (e.g. a service contract in which an entity bills a fixed amount for each hour of service provided) (see **9.3.1**).

An entity should explain qualitatively if it has applied this practical expedient, and whether any consideration from contracts with customers is not included in the transaction price and, therefore, not included in the information disclosed in accordance with IFRS 15:120. For example, an estimate of the transaction price would not include any estimated amounts of variable consideration that are constrained (see **7.2**). [IFRS 15:122]



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Example 14.2.5A

Disclosure of the transaction price allocated to the remaining performance obligations

[IFRS 15:IE212 – IE219, Example 42]

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 [IFRS 15:120 to 122] in determining the information in each contract to be included in the disclosure of the transaction price allocated to the remaining performance obligations at 31 December 20X7.

Contract A

Cleaning services are to be provided over the next two years typically at least once per month. For services provided, the customer pays an hourly rate of CU25.

Because the entity bills a fixed amount for each hour of service provided, the entity has a right to invoice the customer in the amount that corresponds directly with the value of the entity's performance completed to date in accordance with [IFRS 15:B16]. Consequently, no disclosure is necessary if the entity elects to apply the practical expedient in [IFRS 15:121(b)].

Contract B

Cleaning services and lawn maintenance services are to be provided as and when needed with a maximum of four visits per month over the next two years. The customer pays a fixed price of CU400 per month for both services. The entity measures its progress towards complete satisfaction of the performance obligation using a time-based measure.

The entity discloses the amount of the transaction price that has not yet been recognised as revenue in a table with quantitative time bands that illustrates when the entity expects to recognise the amount as revenue. The information for Contract B included in the overall disclosure is as follows:

	20X8	20X9	Total
	CU	CU	CU
Revenue expected to be recognised on this contract as of 31 December 20X7	4,800 ^(a)	2,400 ^(b)	7,200

^(a) CU4,800 = CU400 × 12 months.

^(b) CU2,400 = CU400 × 6 months.



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 [IFRS 15:57], the entity includes its estimate of CU750 of variable consideration in the transaction price because it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. The entity measures its progress towards complete satisfaction of the performance obligation using a time-based measure.

The entity discloses the amount of the transaction price that has not yet been recognised as revenue in a table with quantitative time bands that illustrates when the entity expects to recognise the amount as revenue. The entity also includes a qualitative discussion about any significant variable consideration that is not included in the disclosure. The information for Contract C included in the overall disclosure is as follows:

	20X8	20X9	Total
	CU	CU	CU
Revenue expected to be recognised on this contract as of 31 December 20X7	1,575 ^(a)	788 ^(b)	2,363

^(a) Transaction price = CU3,150 (CU100 × 24 months + CU750 variable consideration) recognised evenly over 24 months at CU1,575 per year.

^(b) CU1,575/2 = CU788 (ie for 6 months of the year).

In addition, in accordance with [IFRS 15:122], 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.



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Example 14.2.5B

Disclosure of the transaction price allocated to the remaining performance obligations – qualitative disclosure

[IFRS 15:IE220 & IE221, Example 43]

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.”

14.3 Significant judgements in the application of IFRS 15

14.3.1 Requirement to disclose significant judgements – general

Disclosure should be made of the judgements, and changes in the judgements, made in applying IFRS 15 that have significantly affected the determination of the amount and timing of revenue from contracts with customers. In particular, an entity should provide an explanation of the judgements, and changes in the judgements, used in determining both of the following:

[IFRS 15:123]

- the timing of satisfaction of performance obligations (see **14.3.2**); and
- the transaction price and the amounts allocated to performance obligations (see **14.3.3**).

14.3.2 Determining the timing of revenue recognition

When performance obligations are satisfied over time, the following should be disclosed:

[IFRS 15:124]

- the methods used to recognise revenue (e.g. a description of the output methods or input methods used and how those methods are applied); and
- an explanation of why the methods used provide a faithful depiction of the transfer of goods or services.

When performance obligations are satisfied at a point in time, the entity should disclose significant judgements made in evaluating when a customer obtains control of promised goods or services. [IFRS 15:125]



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14.3.3 Determining the transaction price and how it is allocated

Disclosure is required regarding the methods, inputs and assumptions used for all of the following:

[IFRS 15:126]

- 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);
- assessing whether an estimate of variable consideration is constrained (see **7.2.8**);
- 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
- measuring obligations for returns, refunds and other similar obligations.

14.4 Capitalised costs

An entity is required to provide descriptions of both of the following:

[IFRS 15:127]

- the judgements made in determining the amount of the costs incurred to obtain or fulfil a contract with a customer (in accordance with IFRS 15:91 (see **12.2**) or IFRS 15:95 (see **12.3.1**)); and
- the method used to determine the amortisation for each reporting period.

The following should also be disclosed:

[IFRS 15:128]

- the closing balances of assets recognised from the costs incurred to obtain or fulfil a contract with a customer (in accordance with IFRS 15:91 or IFRS 15:95), by main category of asset (e.g. costs to obtain contracts with customers, pre-contract costs and setup costs); and
- the amount of amortisation and any impairment losses recognised in the reporting period.

14.5 Disclosure regarding the use of practical expedients

If an entity has elected to use the practical expedient in either IFRS 15:63 (about the existence of a significant financing component – see **7.4.2**) or IFRS 15:94 (about the incremental costs of obtaining a contract – see **12.2**), it should disclose that fact. [IFRS 15:129]



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Section 15. Effective date and transition requirements

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Section 15. Effective date and transition requirements

15.1 Effective date

IFRS 15 is required to be applied for annual reporting periods beginning on or after 1 January 2018, with earlier application permitted. If an entity chooses to apply IFRS 15 for an annual period beginning before 1 January 2018, it is required to disclose that fact. [IFRS 15:C1]

Clarifications to IFRS 15 Revenue from Contracts with Customers, published in April 2016 are also effective for annual periods beginning on or after 1 January 2018, with earlier application permitted and should be applied retrospectively (i.e. the amendments should be applied as if they had been included in IFRS 15 at the date of initial application – see **15.2.1**). An entity should not apply the amendments to reporting periods or to contracts to which the requirements of IFRS 15 are not applied in accordance with the transition guidance in IFRS 15 (see **15.2**). For example, if an entity applies IFRS 15 in accordance with IFRS 15:C3(b) (see **15.2.2**) only to contracts that are not completed at the date of initial application, the entity should not restate completed contracts at the date of initial application for the effect of the clarification amendments. [IFRS 15:C8A]

The effective date of the April 2016 amendments is the same as for IFRS 15. The amendments clarify the IASB's intentions when developing the requirements in IFRS 15 but do not change the underlying principles of the Standard. Entities are generally expected to implement the amendments in the first accounting period in which they apply IFRS 15, although entities that adopt IFRS 15 for a period beginning before 1 January 2018 may choose not to implement the amendments at the same time. In such circumstances, when the entity does subsequently implement the amendments, the effects of initially applying IFRS 15 should be restated for the effects, if any, of initially applying the amendments.

15.2 Transition

15.2.1 Transition to IFRS 15 – general

IFRS 15 provides detailed guidance for entities transitioning to the Standard for the first time. Entities should apply one of the following methods for this purpose:

[IFRS 15:C3]

- (a) a fully retrospective approach – applying IFRS 15 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 (see **15.2.2**); or
- (b) a modified approach – applying IFRS 15 retrospectively with the cumulative effect of initially applying IFRS 15 recognised at the date of initial application in accordance with IFRS 15:C7 to C8 (see **15.2.3**).

For the purposes of these transition provisions:

[IFRS 15:C2]

- (a) the date of initial application is the start of the reporting period in which an entity first applies IFRS 15 (e.g. for an entity adopting IFRS 15 for the first time in the year beginning 1 January 2018, the date of initial application is 1 January 2018); and
- (b) a completed contract is one 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.



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15.2.2 Fully retrospective approach

When an entity opts to use the fully retrospective approach, it is permitted to use one or more of the following practical expedients.

[IFRS 15:C5]

- (a) For completed contracts (see **15.2.1**), the entity is not required to restate contracts that:
 - (i) begin and end within the same annual reporting period; or
 - (ii) are completed contracts at the beginning of the earliest period presented.
- (b) For completed contracts that have variable consideration, the entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts for the comparative reporting periods.
- (c) For contracts that were modified before the beginning of the earliest period presented, an entity need not retrospectively restate the contract for those modifications in accordance with IFRS 15:20 and 21 (see **10.2** and **10.3**). Instead, an entity should reflect the aggregate effect of all of the modifications that occur before the beginning of the earliest period presented when:
 - (i) identifying the satisfied and unsatisfied performance obligations;
 - (ii) determining the transaction price; and
 - (iii) allocating the transaction price to the satisfied and unsatisfied performance obligations.
- (d) The disclosure requirements of IFRS 15:120 (see **14.2.5**) need not be applied for reporting periods presented before the date of initial application (see **15.2.1**).

An entity should apply any of the practical expedients described above consistently to all contracts within all reporting periods presented. The entity should also disclose the following information:

[IFRS 15:C6]

- (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.

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 choose to present this information for the current period or for earlier comparative periods, but is not required to do so. [IFRS 15:C4]

15.2.3 Modified approach

When the entity opts to use the modified approach, it should recognise the cumulative effect of initially applying IFRS 15 as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application (see **15.2.1**) (i.e. the adjustment is made to the statement of financial position at the start of the current reporting period). When using the modified approach, the entity can elect to apply IFRS 15 retrospectively only to contracts that are not completed contracts (see **15.2.1**) at the date of initial application (e.g. 1 January 2018 for an entity adopting IFRS 15 for the first time in the year beginning 1 January 2018). [IFRS 15:C7]



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An entity applying the modified approach may also use the practical expedient described in IFRS 15:C5(c) (see **15.2.2**), either:

[IFRS 15:C7A]

- (a) for all contract modifications that occur before the beginning of the earliest period presented; or
- (b) for all contract modifications that occur before the date of initial application.

If an entity uses this practical expedient, it should be applied to all contracts consistently and the following information should be disclosed:

- (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.

If this method is used, the following should be disclosed for reporting periods that include the date of initial application:

[IFRS 15:C8]

- (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; and
- (b) an explanation of the reasons for significant changes identified in (a) above.

If an entity elects the modified retrospective method when IFRS 15 is first adopted (see **15.2.3**), the cumulative effect of initially applying IFRS 15 is recognised as of the date of initial application, and comparative periods are not restated. Accordingly, an entity would not be required to provide the disclosures under IFRS 15:110 to 129 for the comparative periods presented.

However, IFRS 15:C8 specifies that, in the year of initial application of IFRS 15, entities electing to use the modified retrospective method are required to disclose the impact of changes to financial statement line items as a result of applying IFRS 15 (rather than previous IFRSs) and to include an explanation of the reasons for significant changes.



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Appendix 1 – IFRS 15 Illustrative disclosures

1. Identify the contract(s) with a customer

Illustrative disclosures

IFRS 15 includes extensive disclosure requirements (see **section 14**). This Appendix illustrates the disclosures required to provide information about contracts with customers, significant judgements and changes in judgements made in applying IFRS 15 to those contracts, and any assets recognised from the costs to obtain or fulfil a contract with a customer. The level of detail required to satisfy disclosure objective will be dependent on facts and circumstances and the following key assumptions have been used in the preparation of this Appendix:

- The Group is assumed not to have early adopted IFRS 9 *Financial Instruments* or IFRS 16 *Leases*.
- 1 January 2017 is considered to be the date of initial application of IFRS 15, in accordance with IFRS 15:C2(a), as this is the beginning of the reporting period in which the Group first applied IFRS 15.
- The Group has chosen a full retrospective application of IFRS 15 in accordance with IFRS.15:C3(a) without using the practical expedients for completed contracts in IFRS 15:C5(a) and (b) or for modified contracts in IFRS 15:C5(c) but using the expedient in IFRS 15:C3(d) allowing non-disclosure of the amount of the transaction price allocated to the remaining performance obligations, and an explanation of when it expects to recognise that amount as revenue for all reporting periods presented before the date of initial application, i.e. before 1 January 2017.
- This Appendix does not include a full set of financial statements; only the notes that are affected by the application of IFRS 15 which are relevant to the Group, a non-financial institution, are included. Notes that have been indirectly affected by the change in the profit for the year, i.e. Note Tax, Note Earnings per share and Note Retained earnings have not been illustrated in this Appendix but entities should consider the effect of adjustments resulting from adoption of IFRS 15 on these, and all of the notes in the financial statements.

Statement of financial position line items

[IFRS 15:116(a) requires disclosure of the opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed. Whether these balances are disclosed separately on the face of the financial statements will be a materiality judgement to be made by individual entities based on their own facts and circumstances. Entities will need to consider whether it is appropriate to include separate line items on the face of their consolidated statement of financial position for balances recognised as a result of the application of IFRS 15.

As a result of the adoption of IFRS 15, the disclosures required under IAS 11 Construction Contracts included in Note Construction contracts are no longer required. Note Construction contracts now contains the disclosures around contract asset balances that are required to be made under IFRS 15. Any amounts due to customers previously contained in Note Construction contracts have been reclassified as contract liabilities and are included in a new contract liability note. A refund liability balance has been recognised separately and included in a separate note. Subsequent notes have consequently been renumbered.

A Contract costs note has also been added to disclose costs to obtain contracts that meet the criteria for capitalisation in IFRS 15, and which were previously expensed, and the subsequent notes renumbered.]

Note Significant accounting policies

[IFRS 15 is a complex Standard, introducing far more prescriptive requirements than were previously included in IFRSs, and it may result in substantial changes to revenue recognition policies for some entities. It requires the application of significant judgement in some areas, but in other areas it is relatively prescriptive, allowing little room for judgement.]

As noted in the main part of this publication in the commentary to Note Significant accounting policies, it is recommended that an accounting policy note:

- *describes the policies that are significant given the nature or complexity of the business;*
- *describes the policies that are applied to that specific business and transactions;*
- *excludes references to immaterial policies which can obscure key information; and*
- *avoids boiler-plate text such as extracts from standards or model accounts.]*

Note Critical accounting judgements and key sources of estimation uncertainty

[As the application of IFRS 15 requires significant judgements and certain key estimations, the matters disclosed here will be dictated by the circumstances of the individual entity, and by the significance of judgements and estimates made to the performance and financial position of the entity. Instead of disclosing this information in a separate note, it may be more appropriate to include such disclosures in the relevant asset and liability notes, or as part of the relevant accounting policy disclosures.]

IFRS 15:123 contains a specific disclosure requirement relating to the judgements, and changes in judgements, used in determining both of the following:

- *the timing of satisfaction of performance obligations; and*
- *the transaction price and the amounts allocated to performance obligations.]*

Note Revenue

[IFRS 15:113(a) requires revenue recognised from contracts with customers to be disclosed separately from its other sources of revenue (e.g. rental income) unless that amount is presented separately in the statement of comprehensive income in accordance with other Standards.]

Disaggregation of revenue

	Year ended 20XX £	Year ended 20YY £
Segment revenue		
[Segment A]		
[Segment B]		
[Segment C]		
[Segment D]		
Total		

Timing of revenue recognition

At a point in time		
Over time		
Total		

[IFRS 15:114 requires an entity to 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. This disaggregation will depend on the entity's individual facts and circumstances. The Group has assessed that the disaggregation of revenue by operating segments is appropriate in meeting this disclosure requirement as this is the information regularly reviewed by the chief operating decision maker (CODM) in order to evaluate the financial performance of the entity. The Group also believes that presenting a disaggregation of revenue based on the timing of transfer of goods or services (i.e. at a point in time or over time) provides users of the financial statements with useful information as to the nature and timing of revenue from contracts with customers.]

[If an entity discloses disaggregated revenue on a basis other than that used for revenue information disclosed for each reportable segment then the entity should disclose sufficient information to allow users of the financial statements to understand the relationship between these two disclosures.]

[IFRS 15:120 requires disclosure of the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied (or partially unsatisfied) as at the end of the reporting period. If applying the full retrospective approach on transition. IFRS 15:C5(d) contains a practical expedient under which the transaction price allocated to (partially) unsatisfied performance obligations as at the date of initial application of IFRS 15 does not need to be disclosed.]

The transaction price allocated to (partially) unsatisfied performance obligation at 31 December 20XX are as set out below. As permitted under the transitional provisions in IFRS 15, the transaction price allocated to (partially) unsatisfied performance obligations as of 31 December 20YY is not disclosed.

	Year ended 20XX £
Customer loyalty programme	

Management expects that % of the transaction price allocated to the unsatisfied contracts as of the year ended 20XX will be recognised as revenue during the next reporting period (£_ million). The remaining % (£_ million) will be recognised in the next financial year.

[There is no requirement in IFRS 15 for contract balances (i.e. contract assets, receivables and contract liabilities) to be disclosed together at a single place in the financial statements. Indeed it will likely be more practical for many entities to continue to include balances arising from contracts with customers within the same financial statement line item and related note as previously under IAS 18, for example, contract liabilities within a deferred revenue note. IFRS 15 allows entities to use terminology other than contract asset and contract liability to describe such balances.

Contract balances and the related disclosures have been included in individual notes in this Appendix for illustrative purposes.

Materiality considerations will affect the line items to be disclosed separately within each relevant IFRS 15 balance. In this Appendix for illustrative purposes all line items are disclosed separately.]

	Year ended 20XX £	Year ended 20YY £ Restated
Note Other assets		
Right to returned goods		

The right to returned goods asset represents the Group's right to recover the product from the customer where the customer is expected to exercise his/her right of return under the Group's returns policy. The Group uses its accumulated historical experience to estimate the number of returns on a portfolio level using the expected value method.

Note Contract assets

	Year ended 20XX £	Year ended 20YY £	Year beginning 20YY £
Contract assets	_____	_____	_____
Current	_____	_____	_____
Non-current	_____	_____	_____

[IFRS 15:117 requires an explanation of how the timing of satisfaction of its performance obligations relates to the typical timing of payment and the consequent effect that those factors have on the contract asset and contract liability balances. Entities should ensure that they sufficiently disclose what their contract asset balances relate to and how these balances arise. Additionally an entity should disclose the opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers, if not otherwise separately presented or disclosed. If using the full retrospective transition method an entity will therefore need to ensure that this information is provided for the prior period figures presented i.e. the opening balances for the prior period.]

[IFRS 15:118 contains a requirement to explain the significant changes in the contract asset (and contract liability) balance during the reporting period. This explanation should include qualitative and quantitative information. Examples of changes in the contract asset and liability balances may 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 (i.e. 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 (i.e. for the recognition of revenue arising from a contract liability.)*

There was an impairment loss of £_ recognised on contract assets in the reporting period (20YY: £_).

[IFRS 15:113(b) requires disclosure of any impairment losses recognised on any contract asset in the reporting period.]

Note Contract costs

	Year ended 20XX £	Year ended 20YY £
Costs to obtain contracts	_____	_____
	_____	_____

[IFRS 15:127 and IFRS 15:128 require disclosure of any judgements made in determining the amount of costs incurred to obtain (or fulfil) contracts with customers in addition to the method used to determine the amortisation period for those costs and any impairments recognised.]

Note Contract liabilities

	Year ended 20XX £	Year ended 20YY £	Year beginning 20YY £
Arising from customer loyalty programme Others [describe]	_____	_____	_____
	_____	_____	_____
Current			
Non-current	_____	_____	_____
	_____	_____	_____

There were no significant changes in the contract liability balances during the reporting period.

The following table shows how much of the revenue recognised in the current reporting period relates to brought-forward contract liabilities. There was no revenue recognised in the current reporting period that related to performance obligations that were satisfied in a prior year.

	Year ended 20XX £	Year ended 20YY £
Arising from customer loyalty programme		
Other [describe]	_____	_____
	_____	_____

Note Refund liability

	Year ended 20XX £	Year ended 20YY £
Costs to obtain contracts	_____	_____

Refund liability

The refund liability relates to customers' right to return products within 30 days of purchase. At the point of sale, a refund liability and a corresponding adjustment to revenue is recognised for those products expected to be returned. The Group uses its accumulated historical experience to estimate the number of returns on a portfolio level using the expected value method.

Appendix 2 – Comparison with US GAAP

Although the IASB and FASB standards are nearly fully converged, there are some differences between IFRS 15 and ASC 606, such as those indicated in the following table:

Topic	IFRS 15	ASC 606
Step 1 – the collectability threshold for contracts	Establishes a <i>probable</i> collectability threshold, meaning more likely than not (as defined in IFRS 15 and IAS 37).	Establishes a <i>probable</i> collectability threshold, meaning likely to occur (as defined in ASC 450).
Reversal of impairment losses	An entity is required to reverse an impairment loss on capitalised costs to obtain or fulfill a contract if the impairment conditions no longer exist or have improved.	An entity cannot reverse an impairment loss on capitalised costs to obtain or fulfill a contract.
Interim disclosures	IFRS 15 amended IAS 34 to require entities to provide the disclosures in IFRS 15:114 and 115 relating to the disaggregation of revenue. IFRS 15 did not introduce any further additional requirements for interim reporting.	In addition to those required by ASC 270, an entity must provide interim disclosures about each of the following: <ul style="list-style-type: none"> • The disaggregation of revenue. • Contract asset and contract liability balances and significant changes in those balances. • The transaction price allocated to the remaining performance obligations.
Effective date	Effective for annual reporting periods beginning on or after January 1, 2018. Early adoption is allowed.	<i>Public entities</i> – Effective for annual reporting periods beginning after December 15, 2017. <i>Nonpublic entities</i> – Allowed a one-year delay. <i>Early adoption</i> – Allowed for annual reporting periods beginning on or after December 15, 2016. Nonpublic entities can adopt no earlier than public entities.
Requirements for non-public entities	Applies to all IFRS reporters, including non-public entities.	Applies to non-public entities, with some specific relief related to disclosure, transition, and effective date.

After the IASB and FASB issued IFRS 15 and ASU 2014-09, respectively, the boards decided to amend certain aspects of the new revenue standard. In some cases, the amendments retained convergence; in other cases, however, the IASB decided on a solution that differs from the FASB's. The following table outlines some additional differences between IFRS 15 and ASC 606 that have arisen as a result of the amendments:

Topic	IFRS 15	ASC 606
Licensing – determining the nature of an entity's promise (see paragraphs BC57 through B62 of IFRS 15)	An entity's determination of whether a licence is a right to use versus a right to access is based on meeting specific criteria relating to whether the customer can direct the use of, and obtain substantially all of the benefits from, the licence at the point in time the licence is granted. The customer can direct the use of, and obtain substantially all of the benefits from, the licence if, for example, the underlying IP is not significantly affected by the entity's ongoing activities. Revenue for a right to use licence is recognised at a point in time whereas revenue for a right to access licence is recognised over time.	An entity's determination of whether a licence is a right to use versus a right to access is based on its classification of the intellectual property (IP) underlying the licence as either functional or symbolic.
Licensing – renewals	The contract modification guidance in IFRS 15:18 to 21 should be referred to when a licence is renewed or extended to evaluate whether this renewal or extension should be treated as a new licence or, alternatively, as a modification of the existing contract. Revenue may be recognised earlier than it would be under U.S. GAAP.	A FASB amendment specifies that an entity would generally not recognise revenue relating to the renewal until the beginning of the licence renewal period (the "use and benefit" guidance in ASC 606-10-55-58C).
Shipping and handling activities	Under IFRS 15, If shipping and handling services are provided by an entity after the customer has obtained control of the related goods, these will typically be accounted for as a separate performance obligation.	A FASB amendment provides an accounting policy election that permits an entity to account for shipping and handling activities that occur after the customer has obtained control of the related good as a fulfilment expense.
Non-cash consideration	IFRS 15 does not prescribe a measurement date for non-cash consideration. The variable consideration guidance applies if the fair value of the non-cash consideration promised by a customer varies for reasons other than only the form of the consideration (e.g., a change in the exercise price of a share option because of the entity's performance).	As amended: <ul style="list-style-type: none"> • The FASB's new revenue standard requires measurement at contract inception. • The guidance on variable consideration applies only to variability resulting from reasons other than the form of the non-cash consideration.

Topic	IFRS 15	ASC 606
Presentation of sales (and other similar) taxes	IFRS 15:47 specifies that amounts collected on behalf of third parties, such as some sales taxes, are excluded from the determination of the transaction price. Entities are required to identify and assess sales taxes to determine whether to include or exclude those taxes from the transaction price.	The FASB decided to amend Topic 606 to provide an accounting policy election that permits an entity to exclude all sales (and other similar) taxes from the measurement of the transaction price.
Transition – date of application of the contract modification practical expedient (see paragraph BC445P of IFRS 15)	If an entity uses the modified retrospective method of transition and elects to use the contract modification practical expedient, the entity may apply that practical expedient as of either (1) the date of initial application of the new revenue standard or (2) the beginning of the earliest period presented.	If an entity uses the modified retrospective method of transition and elects to use the contract modification practical expedient, the entity must apply that practical expedient as of the date of initial application of the new revenue standard.
Transition – completed contracts (see paragraphs BC445M through BC445N of IFRS 15)	<ul style="list-style-type: none"> IFRS 15 defines a completed contract as “a contract for which the entity has transferred all of the goods or services identified in accordance with IAS 11 <i>Construction Contracts</i>, IAS 18 <i>Revenue</i> and related Interpretations.” For entities that use the full retrospective method of transition, the IASB added a practical expedient that allows them to elect not to restate contracts that are completed as of the beginning of the earliest period presented. 	<ul style="list-style-type: none"> ASU 2016-12 defines a completed contract as “a contract for which all (or substantially all) of the revenue has been recognised under legacy GAAP before the date of initial application.” ASU 2016-12 makes no changes related to the full retrospective method.
Provisions for losses on construction-type and production-type contracts	Under IAS 37:66-68 the onerous test should be performed at the contract level.	ASU 2016-20 amends the legacy guidance in ASC 605-35-25-47 to clarify that provisions for losses on construction-type and production-type contracts may be determined at either the contract or performance obligation level.
Disclosure of remaining performance obligations	<p>Under IFRS 15: 120 entities must disclose:</p> <ul style="list-style-type: none"> The aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partly unsatisfied as at the end of the reporting period. An explanation of when the entity expects to recognise the revenue disclosed above. 	ASU 2016-20 provides entities with an optional exemption from the requirement to disclose information about remaining performance obligations (ASC 606-10-50-13) for variable consideration if either (1) the variable consideration is a sales-or usage-based royalty promised in exchange for a licence of IP or (2) the variable consideration is allocated entirely to a wholly unsatisfied performance obligation or to a wholly unsatisfied promise to transfer a distinct good or service that forms part of a single performance obligation.

Further, some of the boards' respective amendments to the new revenue standard are generally expected to produce similar outcomes under IFRS 15 and ASC 606 despite differences between the IASB's wording and that of the FASB. The following table provides examples of differently articulated but similar guidance in IFRS 15 and ASC 606, as amended:

Topic	IFRS 15	ASC 606
Collectability – criterion explanation and examples (see paragraphs BC42 through BC46 of IFRS 15)	The IASB decided not to provide any additional guidance on applying the collectability criterion in IFRS 15:9(e).	ASU 2016-12 provides an additional explanation of the collectability threshold's objective, as well as implementation guidance and examples.
Collectability – recognition criterion for contracts that fail step 1 (see paragraph 15 of IFRS 15)	<p>When a contract fails step 1 an entity shall only recognise the consideration received as revenue when one of two events have occurred:</p> <ul style="list-style-type: none"> • There are no remaining obligations to be performed and all/substantially all of the consideration promised has been received and is non-refundable. • The contract has been terminated and the consideration received is non-refundable. 	<p>ASU 2016-12 adds a third criterion to allow revenue recognition when a contract fails step 1 (AS C 606-10-25-1):</p> <ul style="list-style-type: none"> • The goods or services to which the consideration that has been received relates have been transferred, the entity has stopped transferring goods or services to the customer and has no obligation under the contract to transfer additional goods or services and the consideration received is non-refundable. <p>This is to clarify that a contract is terminated when an entity stops transferring promised goods or services rather than when an entity stops pursuing collection from the customer.</p>
Immaterial goods or services (see paragraphs BC116A through BC116E of IFRS 15)	Overall materiality considerations should be used in the evaluation of items under IFRSs	When identifying performance obligations, an entity is not required to assess immaterial items in the context of the contract as promised goods or services.
Licensing – when to consider the nature of an entity's promise in granting a licence (see paragraph BC414O through BC414R of IFRS 15)	There is no explicit guidance on this issue provided in IFRS 15; however, the standard's Basis for Conclusions explains that the licence implementation guidance does not override the general model – specifically, the requirements for identifying performance obligations before applying the criteria to determine the nature of an entity's promise in granting a licence.	ASU 2016-10 contains explicit guidance to indicate that when a bundle of goods or services is determined to be a single performance obligation that includes a licence of IP, an entity should apply the licence implementation guidance to determine whether revenue related to the performance obligation should be recognised over time (including an appropriate measure of progress) or at a point in time.

Topic	IFRS 15	ASC 606
Licensing – contractual restrictions (see paragraphs BC414O through BC414R of IFRS 15)	There is no explicit guidance on this issue provided in IFRS 15; however, the standard’s Basis for Conclusions explains that the licence implementation guidance does not override the general model – specifically, the requirements for identifying performance obligations before applying the criteria to determine the nature of an entity’s promise in granting a licence.	ASU 2016-10 contains explicit guidance to indicate that contractual provisions that explicitly or implicitly require an entity to transfer control of additional goods or services to the customer (e.g., additional rights) should be distinguished from contractual provisions that define attributes of a single promised license (e.g., restrictions of time or geography).
Contract costs – impairment testing	No additional guidance provided as to specific factors to consider when testing capitalised contract costs for impairment.	ASU 2016-20 clarifies that when an entity tests capitalised contract costs for impairment, it should (1) consider expected contract renewals and extensions and (2) include any amount of consideration not yet recognised as revenue (i.e., consideration already received and amounts expected to be received in the future).
Disclosure of prior-period performance obligations	IFRS 15:116 requires disclosure of revenue recognised from performance obligations satisfied (or partially satisfied) in previous periods.	ASU 2016-20 provides additional guidance to clarify that the disclosure of revenue from performance obligations satisfied (or partially satisfied) in prior periods applies to all performance obligations (i.e., the disclosure is not isolated to performance obligations with corresponding contract liability balances).
Contract modifications example	No amendments made to the wording in Example 7 (IFRS 15:IE33-IE36).	ASU 2016-20 amends Example 7 in ASC 606-10-55-125 through 55-128 to better align the wording with the contract modification guidance in ASC 606-10-25-10 through 25-13.
Contract asset versus receivable	No amendments made to the wording in Example 38, Case B (IFRS 15:IE199-IE200).	ASU 2016-20 amends Example 38, Case B, in ASC 606-10-55-285 and 55-286 to provide a better link between the analysis and the receivables presentation guidance in ASC 606.
Refund liability	No amendments made to the wording in Example 40 (IFRS 15:IE205-IE209).	ASU 2016-20 amends Example 40 in ASC 606-10-55-293 to remove the reference to a contract liability as related to refund liabilities.

In addition, there are certain differences between legacy IFRSs and U.S. GAAP. While certain of the boards’ respective amendments to legacy GAAP – especially the FASB’s amendments in ASU 2016-20 – are not expected to create a new difference between IFRSs and U.S. GAAP, these amendments are also not expected to result in convergence between IFRSs and U.S. GAAP. The following table provides examples of where existing differences are expected to be carried forward under the new revenue standard and are not expected to be affected by the FASB’s amendments in ASU 2016-20.

Topic	IFRSs	US GAAP
Financial guarantee contracts	<p>The issuer of a financial guarantee contract should, in accordance with IFRS 9, initially recognise the contract at fair value and subsequently measure it at the higher of:</p> <ul style="list-style-type: none"> • The amount of the loss allowance determined in accordance with Section 5.5 of IFRS 9; and • The amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with IFRS 15. 	<p>ASU 2016-20 clarifies that guarantee fees (other than product or service warranties) within the scope of ASC 460 are not within the scope of ASC 606.</p>
Contract costs – interaction of impairment testing with guidance in other IFRSs	<p>IFRS 15:103 clarifies that before recognising any impairment loss for a capitalised contract, an entity should recognise any impairment loss for assets related to the contract that are recognised in accordance with another Standard (e.g. IAS 2, IAS 16 and IAS 38). The resulting carrying amount of the asset should then be included in the carrying amount of the cash-generating unit to which it belongs for the purposes of applying IAS 36.</p>	<p>ASU 2016-20 clarifies that impairment testing on assets should be performed in the following order: (1) assets not within the scope of ASC 340, ASC 350, or ASC 360; (2) assets within the scope of ASC 340 (including contract costs capitalised under ASC 340-40); (3) asset groups and reporting units within the scope of ASC 360 and ASC 350.</p>
Scope of the new revenue standard	<p>IFRS 15:5 clarifies that insurance contracts within the scope of IFRS 4 (IFRS 17 from 2021) are not within the scope of IFRS 15.</p>	<p>ASU 2016-20 clarifies that all contracts within the scope of ASC 944 are not within the scope of ASC 606 by removing the term “insurance” from ASC 606-10-15-2(b).</p>
Advertising costs	<p>No guidance on this issue is provided in IFRS 15.</p>	<p>ASU 2016-20 reinstates the guidance on the accrual of advertising costs that was previously in ASC 340-20 and superseded by ASU 2014-09. The reinstated guidance will be moved to ASC 720.</p>
Cost capitalisation for advisers to private funds and public funds	<p>IFRSs do not contain prescriptive guidance on the accounting for costs incurred by advisers to public and private funds.</p>	<p>ASU 2016-20 amends the guidance in ASC 946-720 to align the cost capitalisation guidance for advisers to both public and private funds.</p>
Fixed-odds wagering contracts in the casino industry	<p>IFRIC previously noted that when a gaming entity takes a position against a customer, the resulting unsettled wager is a financial instrument that is likely to meet the definition of a derivative and should therefore be accounted for under IAS 39/IFRS 9. At the November 2015 TRG meeting the IASB commented that wagering contracts that meet the definition of a financial instrument within the scope of IAS 39/IFRS 9 are excluded from the scope of IFRS 15.</p>	<p>ASU 2016-20 clarifies that fixed-odds wagering contracts in the casino industry should be accounted for under the new revenue standard by providing a scope exception from the derivatives guidance in newly created ASC 924-815.</p>

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