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Illustrative Examples  
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# Revenue from Contracts with Customers

Comments to be received by 13 March 2012

**Illustrative Examples on  
Exposure Draft  
Revenue from Contracts  
with Customers**

*Comments to be received by 13 March 2012*

**ED/2011/6**

These Illustrative Examples accompany the proposed International Financial Reporting Standard (IFRS) set out in the exposure draft *Revenue from Contracts with Customers* (issued November 2011; see separate booklet). Comments on the draft IFRS and its accompanying documents should be submitted in writing so as to be received by **13 March 2012**. Respondents are asked to send their comments electronically to the IFRS Foundation website ([www.ifrs.org](http://www.ifrs.org)), using the 'Comment on a proposal' page.

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## **[Draft] IFRS X Revenue from Contracts with Customers Illustrative examples**

*These examples accompany, but are not part of, the [draft] IFRS. They illustrate aspects of the [draft] IFRS but are not intended to provide interpretive guidance.*

### **Introduction**

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IE1 [IG59]\* The following examples are an integral part of the [draft] IFRS and are intended to illustrate how an entity might apply some of the requirements of the [draft] IFRS to particular aspects of a contract with a customer on the basis of the limited facts presented. Additional facts most likely would be required to fully evaluate the contract. The evaluations following each example are not intended to represent the only manner in which the [draft] IFRS could be applied.

IE2 [IG60] The examples correspond with the following topics in the [draft] IFRS and application guidance:

- (a) contract modifications (paragraph IE3);
- (b) identifying separate performance obligations (paragraph IE4);
- (c) satisfaction of performance obligations (paragraphs IE5 and IE6);
- (d) measuring progress towards complete satisfaction of a performance obligation (paragraph IE7);
- (e) the time value of money (paragraph IE8);
- (f) consideration payable to a customer (paragraph IE9);
- (g) allocating the transaction price to separate performance obligations (paragraphs IE10 and IE11);
- (h) constraining the cumulative amount of revenue recognised (paragraphs IE12 and IE13);
- (i) costs to obtain and fulfil a contract (paragraph IE14);
- (j) amortisation of an asset recognised from costs to fulfil a contract (paragraph IE15);
- (k) presentation (paragraph IE16);

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\* The relevant paragraph numbers for the FASB exposure draft are included in the square brackets.

- (l) reconciliation of contract balances (paragraph IE17);
- (m) sale with a right of return (paragraph IE18);
- (n) warranties (paragraph IE19);
- (o) customer options for additional goods or services (paragraphs IE20–IE22); and
- (p) licensing (paragraph IE23).

## **Contract modifications (paragraphs 18–22)**

IE3 The following examples illustrate the requirements in paragraphs 18–22  
[IG61] on contract modifications.

### **Example 1—Separate contract for goods**

An entity promises to sell 120 products to a customer for CU12,000\* (CU100 per product). The products are transferred to the customer at various points in time over a six-month period. The contract is modified after 60 products have been transferred and the entity promises to deliver an additional 30 products for 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. In addition, the additional products are distinct from the original products because the entity regularly sells the products separately. Therefore, 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.

If the pricing for the additional products did not reflect the stand-alone selling price of the additional products, the entity would allocate the modified transaction price (less the amounts allocated to products transferred at or before the date of the modification) to all remaining products to be transferred. Consequently, the amount recognised as revenue for each of the remaining products would be a blended price of CU98.33  $\{[(CU100 \times 60 \text{ products not yet transferred under original contract}) + (CU95 \times 30 \text{ products to be transferred under the contract modification})] \div 90 \text{ remaining products}\}$  per product.

\* In these examples, monetary amounts are denominated in ‘currency units (CU)’.

**Example 2—Modification of a services contract**

An entity enters into a three-year services contract. The customer promises to pay CU100,000 at the beginning of each year. The stand-alone selling price of the services at contract inception is CU100,000 per year. At the end of the second year, the contract is modified and the fee for the third year of services is reduced to CU80,000. In addition, the customer agrees to pay an additional CU200,000 to extend the contract for three additional years (ie four years remain after the modification). 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 multiplied by the number of years 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).

At the date of modification, the entity evaluates the remaining services to be provided and concludes that they are distinct in accordance with paragraphs 28 and 29. 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). Hence, the entity would reallocate the remaining consideration of CU280,000 to the remaining services to be provided and would recognise revenue of CU70,000 per year (CU280,000 ÷ 4 years) as the services are provided.

**Example 3—Modification of an existing performance obligation**

An entity enters into a contract to construct a house for a customer, which is considered to be a single performance obligation. That is because in accordance with paragraph 29 the goods or services in the bundle are highly interrelated and providing them to the customer requires the entity to also provide a significant service of integrating the goods or services into the combined item (ie the house) for which the customer has contracted. In addition, the goods or services are significantly modified and customised to fulfil the contract. At inception, the entity expects the following:

	CU
Transaction price	1,000,000
Expected costs	<u>800,000</u>
Expected profit (20%)	<u><u>200,000</u></u>

*continued...*



*...continued***Example 3—Modification of an existing performance obligation**

By the end of the first year, the entity has satisfied 50 per cent of its performance obligation on the basis of costs incurred (CU400,000) relative to total expected costs (CU800,000). Hence, the cumulative revenue and costs recognised for the first year are as follows:

	CU
Revenue	500,000
Costs	400,000
Gross profit	<u>100,000</u>

At the beginning of the second year, the parties to the contract agree to change the floor plan of the house. As a result, the contract revenue and expected costs increase by CU100,000 and CU75,000, respectively. The entity concludes that the remaining goods and services to be provided under the modified contract are not distinct in accordance with paragraphs 28 and 29 because the entity provides a significant service of integrating the highly interrelated goods and services into the combined item (the house) for which the customer has contracted. In addition, providing the house requires the entity to significantly modify the promised goods and services.

Consequently, the entity accounts for the contract modification as if it were part of the original contract. The entity updates its measure of progress and estimates that it has satisfied 45.7 per cent of its performance obligation (CU400,000 actual costs incurred ÷ CU875,000 total expected costs). In addition, the entity would recognise additional revenue of CU2,700 (45.7% complete × CU1,100,000 modified transaction price – CU500,000 revenue recognised to date).

## Identifying separate performance obligations (paragraphs 23–30)

IE4 [IG62] The following examples illustrate the requirements in paragraphs 23–30 on determining whether to account for a bundle of goods or services as one performance obligation.

**Example 4—Significant customisation of software**

An entity licences customer relationship management software to a customer. In addition, the entity promises to provide consulting services to significantly customise the software to the customer's information technology environment for total consideration of CU600,000.

The entity is providing a significant service of integrating the goods and services (the licence and the consulting services) into the combined item for which the customer has contracted. In addition, the software is significantly customised by the entity in accordance with the specifications negotiated with the customer. Hence, the entity would account for the licence and consulting services together as one performance obligation. Revenue for that performance obligation would be recognised over time by selecting an appropriate measure of progress towards complete satisfaction of the performance obligation (assuming the criteria in paragraph 35 are met for satisfaction of a performance obligation over time).

**Example 5—Construction**

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

The entity would account for the bundle of goods and services as a single performance obligation in accordance with paragraph 29 because the goods or services in the bundle are highly interrelated and providing them to the customer requires the entity to also provide a significant service of integrating the goods or services into the combined item (ie the hospital) for which the customer has contracted. In addition, the goods or services are significantly modified and customised to fulfil the contract.

Revenue for the performance obligation would be recognised over time by selecting an appropriate measure of progress towards complete satisfaction of the performance obligation (assuming the criteria in paragraph 35 are met for satisfaction of a performance obligation over time).

## **Satisfaction of performance obligations (paragraphs 31–37)**

IE5 [IG63] The following example illustrates the requirements for identifying separate performance obligations and determining when a performance obligation is satisfied if the entity retains the risk of loss during shipment of a product.

### **Example 6—Shipment of a product with risk of loss**

An entity enters into a contract to sell a product to a customer. The delivery terms of the contract are free on board shipping point (ie legal title to the product passes to the customer when the product is handed over to the carrier). The entity uses a third-party carrier to deliver the product. In accordance with the entity's past business practices, the entity will provide the customer with a replacement product, at no additional cost, if a product is damaged or lost while in transit. The entity has determined that its past business practices of replacing damaged products has implicitly created a performance obligation.

Hence, the entity has two performance obligations: (a) to provide the customer with a product and (b) to cover the risk of loss during transit. The customer obtains control of the product at the point of shipment. Although it does not have physical possession of the product at that point, it has legal title and therefore can sell the product to (or exchange it with) another party. The entity is also precluded from selling the product to another customer.

In this example, the additional performance obligation for risk coverage does not affect when the customer obtains control of the product. However, it does result in the customer receiving a service from the entity while the product is in transit. Hence, the entity has not satisfied all of its performance obligations at the point of shipment and would not recognise all of the revenue at that time. Instead, the entity would allocate a portion of the transaction price to the performance obligation to provide risk coverage and would recognise revenue as that performance obligation is satisfied.

IE6 The following example illustrates the requirements in paragraphs 35 and  
 [IG64] 36 on determining whether an asset has an alternative use to an entity and if one of the criteria is met for satisfaction of a performance obligation over time.

**Example 7—Determining whether an asset has an alternative use to an entity**

An entity is developing residential real estate and starts marketing individual units (apartments). The entity has entered into the minimum number of contracts that are needed to begin construction.

A customer enters into a binding sales contract for a specified unit that is not yet ready for occupancy. The customer pays a non-refundable deposit at inception of the contract and also promises to make payments throughout the contract. Those payments are intended to at least compensate the entity for performance completed to date and are refundable only if the entity fails to deliver the completed unit. The entity receives the final payment only on completion of the contract (ie when the customer obtains possession of the unit).

To finance the payments, the customer borrows from a financial institution that makes the payments directly to the entity on behalf of the customer. The lender has full recourse against the customer. The customer can sell his or her interest in the partially completed unit, which would require approval of the lender but not the entity. The customer is able to specify minor variations to the basic design but cannot specify or alter major structural elements of the unit's design. The contract precludes the entity from transferring the specified unit to another customer.

The asset (apartment) created by the entity's performance does not have an alternative use to the entity because the contract has substantive terms that preclude the entity from directing the unit to another customer. The entity concludes that it has a right to payment for performance completed to date because the customer is obliged to compensate the entity for its performance rather than only a loss of profit if the contract is terminated. In addition, the entity expects to fulfil the contract as promised. Therefore, the terms of the contract and the surrounding facts and circumstances indicate that the entity has a performance obligation that it satisfies over time.

To recognise revenue for that performance obligation satisfied over time, the entity would measure its progress towards completion in accordance with paragraphs 38–48.

## Measuring progress towards complete satisfaction of a performance obligation (paragraphs 38–48)

IE7 [IG65] The following example illustrates the requirements in paragraph 46 on applying an input method to measure progress if the entity has a single performance obligation that includes goods (for example, specialised materials) that the customer obtains control of before services related to those goods (for example, installation).

### Example 8—Uninstalled materials

An entity enters into a contract with a customer to construct a facility for CU140 million over two years. The contract also requires the entity to procure specialised equipment from a third party and integrate that equipment into the facility. The entity expects to transfer control of the specialised equipment approximately six months from when the project begins. The installation and integration of the equipment continue throughout the contract. The contract is a single performance obligation in accordance with paragraph 29 because all of the promised goods or services in the contract are highly interrelated and the entity also provides a significant service of integrating those goods or services into the single facility for which the customer has contracted. In addition, the entity significantly modifies the bundle of goods and services to fulfil the contract. The entity measures progress towards complete satisfaction of the performance obligation on the basis of costs incurred relative to total costs expected to be incurred.

At contract inception, the entity expects the following:

Transaction price		CU140,000,000
Cost of the specialised equipment	CU40,000,000	
Other costs	CU80,000,000	
Total expected costs		<u>CU120,000,000</u>

In accordance with paragraph 46, the entity concludes that the best depiction of the entity's performance is to recognise revenue for the specialised equipment in an amount equal to the cost of the specialised equipment upon the transfer of control to the customer. Hence, the entity would exclude the cost of the specialised equipment from its measure of progress towards complete satisfaction of the performance obligation on a cost-to-cost basis and account for the contract as follows.

*continued...*

...continued

**Example 8—Uninstalled materials**

During the first six months, the entity incurs CU20,000,000 of costs relative to the total CU80,000,000 of expected costs (excluding the CU40,000,000 cost of the specialised equipment). Hence, the entity estimates that the performance obligation is 25 per cent complete ( $\text{CU}20,000,000 \div \text{CU}80,000,000$ ) and recognises revenue of CU25,000,000 [ $25\% \times (\text{CU}140,000,000 \text{ total transaction price} - \text{CU}40,000,000 \text{ revenue for the specialised equipment})$ ].

Upon transfer of control of the specialised equipment, the entity recognises revenue and costs of CU40,000,000.

Subsequently, the entity continues to recognise revenue on the basis of costs incurred relative to total expected costs (excluding the revenue and cost of the specialised equipment).

## The time value of money (paragraphs 58–62)

IE8 [IG66] The following example illustrates how an entity would apply the requirements in paragraphs 58–62 to account for the effects of the time value of money.

**Example 9—Time value of money in a multiple-element arrangement**

An entity enters into a contract to sell Product A and Product B for an upfront cash payment of CU150,000. Product A will be delivered in two years and Product B will be delivered in five years. The entity allocates the CU150,000 to Products A and B on a relative stand-alone selling price basis as follows:

	<i>Stand-alone selling prices</i>	<i>Per cent allocated</i>	<i>Allocated amounts</i>
	CU		CU
Product A	40,000	25%	37,500
Product B	120,000	75%	112,500
Total	<u>160,000</u>		<u>150,000</u>

The entity uses a financing rate of 6 per cent, which is the entity's incremental borrowing rate.

*continued...*

*...continued***Example 9—Time value of money in a multiple-element arrangement**

The following journal entries illustrate how an entity would account for the effects of the time value of money.

- (a) Recognise the contract liability for the CU150,000 payment at contract inception.

Dr Cash	CU150,000
Cr Contract liability	CU150,000

- (b) During the two years from contract inception until the transfer of Product A, recognise the interest expense on CU150,000 at 6 per cent for two years.

Dr Interest expense	CU18,540 <sup>a</sup>
Cr Contract liability	CU18,540

- (c) Recognise revenue for the transfer of Product A.

Dr Contract liability	CU42,135 <sup>b</sup>
Cr Revenue	CU42,135

- (d) Recognise the interest expense for three years on the remaining contract liability of CU126,405.<sup>c</sup>

Dr Interest expense	CU24,145 <sup>d</sup>
Cr Contract liability	CU24,145

- (e) Recognise revenue for the transfer of Product B.

Dr Contract liability	CU150,550 <sup>e</sup>
Cr Revenue	CU150,550

<sup>a</sup> CU18,540 = CU150,000 contract liability  $\times$  (1.06<sup>2</sup> - 1).

<sup>b</sup> CU42,135 = CU37,500 initial allocation to Product A + CU4,635, which is Product A's portion (25 per cent) of the CU18,540 interest for the first 2 years of the contract.

<sup>c</sup> CU126,405 = CU150,000 initial contract liability + CU18,540 interest for 2 years - CU42,135 derecognised from the transfer of Product A.

<sup>d</sup> CU24,145 = CU126,405 contract liability balance after 2 years  $\times$  (1.06<sup>3</sup> - 1).

<sup>e</sup> CU150,550 = CU126,405 contract liability balance after 2 years + CU24,145 interest for 3 years.

## Consideration payable to a customer (paragraphs 65–67)

IE9 The following example illustrates the requirements in paragraph 67 on  
[IG67] consideration payable to the customer.

### Example 10—Volume discount incentive

An entity enters into a contract with a customer 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 price per unit is retroactively reduced to CU90 per unit. The entity's experience is predictive of the amount of consideration to which the entity will be entitled.

For the first quarter ended 31 March, the entity sells 90 units of Product A to the customer and the entity estimates that the customer's purchases will not exceed the 1,000 units threshold required for the volume discount in the calendar year. Hence, the entity recognises revenue of CU9,000 (90 units × CU100 per unit) for the period ended 31 March. The entity is reasonably assured to be entitled to that amount.

In June, the entity's customer acquires another company. As a result, the entity estimates that the customer's purchases will exceed the 1,000 units threshold for the calendar year. For the second quarter ended 30 June, the entity sells an additional 500 units of Product A to the customer. Hence, the entity recognises revenue of CU44,100 for the period ended 30 June. That amount equals CU45,000 for the sale of 500 units (500 units × CU90 per unit) less CU900 (90 units × CU10 price reduction) for the reduction of revenue relating to units sold for the quarter ended 31 March. The entity is reasonably assured to be entitled to that amount.



## Allocating the transaction price to separate performance obligations (paragraphs 70–85)

IE10 [IG68] The following example illustrates the requirements in paragraph 75 on allocating a discount to only one performance obligation in a contract rather than to all separate performance obligations in the contract.

### Example 11—Allocating a discount

An entity enters into a contract with a customer to sell Products A, B and C for a total transaction price of CU36. The entity regularly sells Products A, B and C on a stand-alone basis for the following prices:

	<i>Stand-alone selling prices</i>
	CU
Product A	9
Product B	11
Product C	20
Total	<u>40</u>

The customer receives a CU4 discount (CU40 sum of stand-alone selling prices – CU36 transaction price) for buying the bundle of three products. Because Products A and B are transferred at the same time, the entity accounts for only two separate performance obligations in accordance with paragraph 30: one for Products A and B combined and another for Product C. The entity regularly sells Products A and B as a bundle for CU16 (ie at a CU4 discount). Because the entity regularly sells Products A and B together for CU16 and regularly sells Product C for CU20, the entity has observable prices as evidence that the CU4 discount in the contract should be allocated only to Products A and B. Hence, the entity allocates the transaction price of CU36 as follows:

	<i>Allocated amounts</i>
	CU
Products A and B	16
Product C	20
Total	<u>36</u>

IE11 [IG69] The following example illustrates the requirements in paragraphs 70–76 on allocating the transaction price in a contract with contingent consideration and paragraphs 81–85 on constraining the cumulative amount of revenue when the promised amount of consideration is variable.

**Example 12—Multiple performance obligations and contingent consideration**

*Scenario 1*

An entity enters into a contract with a customer for two intellectual property licences (Licence A and Licence B), which are two separate performance obligations. The stated price for Licence A is a fixed amount of CU800 and for Licence B the price is 3 per cent of the customer's future sales of products that use Licence B. The entity's estimate of the transaction price is CU1,700 (which includes CU900 of estimated royalties for Licence B). The estimated stand-alone selling prices of Licences A and B are CU800 and CU1,000, respectively.

Applying the criteria in paragraph 76, the entity would allocate the contingent royalty payment of CU900 entirely to Licence B because that contingent payment relates specifically to an outcome from the performance obligation to transfer Licence B (ie the customer's subsequent sales of products that use Licence B). In addition, allocating the expected royalty amounts of CU900 entirely to Licence B is consistent with the allocation principle in paragraph 70 when considering the other payment terms and performance obligations in the contract.

The entity transfers Licence B at inception of the contract and transfers Licence A one month later. Upon transfer of Licence B, the entity recognises as revenue only the amount to which it is reasonably assured to be entitled. Because the expected royalty amount of CU900 varies entirely on the basis of the customer's subsequent sales of products that use Licence B, the entity is not reasonably assured to receive that amount until the customer's subsequent sales occur (in accordance with paragraph 85). Therefore, the entity would not recognise revenue at the CU900 allocated amount until the customer sells the products that use Licence B.

When Licence A is transferred, the entity would recognise as revenue the CU800 allocated to Licence A.

*continued...*

*...continued*

**Example 12—Multiple performance obligations and contingent consideration**

**Scenario 2**

An entity enters into a contract with a customer for two intellectual property licences (Licence A and Licence B), which are two separate performance obligations. The stated price for Licence A is CU300 and for Licence B the price is 5 per cent of the customer's future sales of products using Licence B. The entity's estimate of the transaction price is CU1,800 (which includes CU1,500 of royalties for Licence B). The estimated stand-alone selling prices of Licences A and B are CU800 and CU1,000, respectively.

Applying the criteria in paragraph 76, the entity concludes that even though the contingent payment relates to subsequent sales of Licence B, allocating that amount entirely to Licence B would not be consistent with the principle for allocating the transaction price because the contingent payment does not reflect the amount to which the entity expects to be entitled in exchange for Licence B when considering the other payment terms and performance obligations in the contract. Hence, the entity would allocate the total transaction price of CU1,800 (CU300 fixed payment + CU1,500 contingent payment) to Licences A and B on a relative stand-alone selling price basis of CU800 and CU1,000, respectively.

The entity transfers Licence A at the inception of the contract and transfers Licence B one month later. Upon transfer of Licence A, the entity recognises as revenue only the amount to which it is reasonably assured to be entitled. Because the CU1,500 varies entirely on the basis of the customer's subsequent sales of products that use Licence B, the entity is not reasonably assured to receive that amount until the customer's subsequent sales occur (in accordance with paragraph 85). Therefore, the amount of revenue recognised for Licence A is limited to CU300 at the time of transfer of Licence A to the customer.

Any contingent payments relating to Licence B would be recognised as revenue as the customer sells the products that use Licence B.

## Constraining the cumulative amount of revenue recognised (paragraphs 81–85)

IE12 The following example illustrates the requirements in paragraphs 81–85  
[IG70] on constraining cumulative revenue to amounts that are reasonably assured.

### Example 13—Management fees

On 1 January, an entity enters into a contract with a client to provide asset management services for one year. The entity receives a quarterly management fee based on a percentage of 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 index at the end of the year.

Although each increment of service is distinct in accordance with paragraphs 28 and 29, the entity accounts for the contract as a single performance obligation to provide investment management services for one year because the services have the same pattern of transfer to the customer (see paragraph 30).

To recognise revenue for satisfying the performance obligation over time, the entity selects an output method of measuring progress towards complete satisfaction of the performance obligation.

The entity concludes that it is not reasonably assured to be entitled to the incentive fee until the end of the year. Although the entity has experience with similar contracts, that experience is not predictive of the outcome of the current contract because the amount of consideration is highly susceptible to volatility in the market.

In addition, the incentive fee has a large number and high variability of possible consideration amounts.

Because the entity is not yet reasonably assured to be entitled to the incentive fee, the cumulative amount of revenue recognised during the year is limited to the quarterly management fees. Therefore, in accordance with paragraph 42, the entity directly measures the value of the services provided to the customer to date by reference to the quarterly management fees for which the entity has a right to invoice. In other words, the quarterly management fee is an appropriate depiction of the amount of consideration to which the entity expects to be entitled in exchange for the services provided each quarter.

IE13 [IG71] The following example illustrates how an entity would apply the requirements in paragraphs 81–85 to a situation in which an entity has experience with similar types of contracts and that experience is predictive of the amount of consideration to which the entity will be entitled. This example does not consider potential effects of the time value of money.

**Example 14—Trailing commission**

An entity sells an insurance policy on behalf of an insurance company for a commission of CU100. In addition, the entity will receive an additional commission of CU10 each year for as long as the policyholder does not cancel its policy. After selling the policy, the entity does not have any remaining performance obligations.

The entity has significant experience with similar types of contracts and customers. The entity's experience is predictive of the amount of consideration to which the entity will be entitled because it has reliable data from past contracts about the likely level of policyholder terminations and has no evidence to suggest that previous policyholder behaviour will change.

The entity determines that the transaction price is CU145 (because on average, customers renew for 4.5 years) and allocates that amount to the performance obligation. When the entity satisfies its performance obligation by selling the insurance policy to the customer, it recognises revenue of CU145 because it determines that it is reasonably assured to be entitled to that amount. The entity concludes that its past experience is predictive, even though the total amount of commission that the entity ultimately will receive depends on the actions of a third party (ie policyholder behaviour). As circumstances change, the entity updates its estimate of the transaction price and recognises revenue (or a reduction of revenue) for those changes in circumstances.

## **Incremental costs of obtaining a contract and costs to fulfil a contract (paragraphs 91–97)**

IE14 [IG72] The following example illustrates the requirements in paragraphs 91–97 on accounting for costs incurred to obtain and fulfil a contract that do not give rise to an asset eligible for recognition in accordance with another IFRS (for example, IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment*, or IAS 38 *Intangible Assets*).

**Example 15—Costs that give rise to an asset**

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

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

The CU10,000 incremental costs of obtaining the contract are recognised as an asset in accordance with paragraph 94. The asset is amortised over the term of the 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	<u>350,000</u>

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

- (a) Hardware costs—accounted for in accordance with IAS 16.
- (b) Software costs—accounted for in accordance with IAS 38.
- (c) Costs of the design, migration and testing of the data centre—considered for capitalisation in accordance with paragraph 91. Any resulting asset would be amortised on a systematic basis over five years as the entity provides the services outsourced by the customer.

## Amortisation of an asset recognised from costs to fulfil a contract (paragraphs 98–103)

IE15 [IG73] The following example illustrates the requirements in paragraph 98 on amortising an asset recognised from the costs to fulfil a contract when that asset relates to goods or services to be provided under future contracts with the same customer.

### Example 16—Amortisation

An entity enters into a contract with a customer for one year of transaction-processing services. The entity charges the customer a non-refundable upfront fee in part as compensation for the initial activities of setting up the customer on the entity's systems and processes. The customer can renew the contract each year without paying the initial fee.

The entity's set-up activities do not transfer any service to the customer and, hence, do not give rise to a performance obligation. Therefore, the entity recognises as revenue the initial fee over the period that it expects to provide services to the customer, which may exceed the one year of the initial contract term.

The incurred set-up costs enhance resources of the entity that will be used in satisfying performance obligations in the future and those costs are expected to be recovered. Therefore, the entity would recognise the set-up costs as an asset, which would be amortised over the period that the entity expects to provide services to the customer (consistent with the pattern of revenue recognition), which may exceed the one year of the initial contract term.

## Presentation (paragraphs 104–108)

IE16 The following examples illustrate the presentation requirements in [IG74] paragraphs 104–108.

### Example 17—Contract liability and receivable

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

When the amount of consideration is due on 31 January:

Dr Receivable	CU1,000
Cr Contract liability	CU1,000

On receiving the cash on 1 March:

Dr Cash	CU1,000
Cr Receivable	CU1,000

On satisfying the performance obligation on 31 March:

Dr Contract liability	CU1,000
Cr Revenue	CU1,000

If the contract were cancellable, the entity would not make the above accounting entry on 31 January because it would not have a receivable. Instead, it would recognise the cash and contract liability on 1 March.

### Example 18—Contract asset and receivable

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

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

*continued...*



<i>...continued</i>		
<b>Example 18—Contract asset and receivable</b>		
On satisfying the performance obligation to transfer Product X:		
Dr Contract asset		CU400
	Cr Revenue	CU400
On satisfying the performance obligation to transfer Product Y:		
Dr Receivable		CU1,000
	Cr Contract asset	CU400
	Cr Revenue	CU600

## **Reconciliation of contract balances (paragraph 117)**

IE17 [IG75] The following example illustrates the requirement in paragraph 117 to disclose a reconciliation of contract assets and contract liabilities:

<b>Example 19—Reconciliation of contract assets and contract liabilities</b>	
<p>An entity has two main business units: a services business and a retail business. Customers of the services business typically pay a portion of the promised consideration in advance of receiving the services and the remaining amount upon completion of the services. The service contracts do not include a significant financing component. Customers of the retail business typically pay in cash at the time of transfer of the promised goods.</p> <p>During 20X1, the entity recognised revenue of CU18,500 from contracts with customers (CU1,000 of which was cash sales from the entity's retail business). The entity received CU3,500 payments in advance.</p> <p style="text-align: right;"><i>continued...</i></p>	

...continued

**Example 19—Reconciliation of contract assets and contract liabilities**

Included in the transaction price of one of the entity's services contracts is a performance bonus that the entity will receive only if it meets a specified milestone by a specified date. The entity includes that performance bonus in the transaction price and recognises revenue over time using an appropriate method of measuring progress.

As of 31 December 20X0, the entity was not reasonably assured to be entitled to the cumulative amount of consideration that was allocated to the entity's past performance at that date. However, during 20X1 the entity became reasonably assured to be entitled to the performance bonus. Consequently, the entity recognised a contract asset and revenue of CU500 for the portion of the bonus relating to the entity's performance in the previous reporting period.

As a result of a business combination on 31 December 20X1, the entity's contract assets increased by CU4,000 and its contract liabilities increased by CU1,900.

	CU
Contract assets	–
Contract liabilities	(2,000)
<b>Net contracts at 31 December 20X0</b>	<b>(2,000)</b>
Revenue from contracts with customers	
Performance obligations satisfied during the reporting period	18,000
Amounts allocated to performance obligations satisfied in previous periods	500
	<u>18,500</u>
Amounts recognised as receivables	(14,000)
Payments in advance	(3,500)
Cash sales	(1,000)
Effects of a business combination	
Increase of contract assets	4,000
Increase of contract liabilities	(1,900)
<b>Net contracts at 31 December 20X1</b>	<b><u>100</u></b>
Contract assets	<u>4,500</u>
Contract liabilities	(4,400)

## Sale with a right of return (paragraphs B2–B9)

IE18 The following example illustrates the requirements in B2–B9 on [IG76] accounting for the sale of products with a right of return.

### Example 20—Right of return

An entity sells 100 products for CU100 each. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The cost of each product is CU60. To determine the transaction price, the entity decides that the approach that is most predictive of the amount of consideration to which the entity will be entitled is the most likely amount. Using the most likely amount, the entity estimates that three products will be returned. The entity's experience is predictive of the amount of consideration to which the entity will be entitled.

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

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

Consequently, the entity would recognise:

- (a) Revenue of CU9,700 ( $\text{CU}100 \times 97$  products expected not to be returned).
- (b) A refund liability for CU300 ( $\text{CU}100$  refund  $\times$  3 products expected to be returned).
- (c) An asset of CU180 ( $\text{CU}60 \times 3$  products) for its right to recover products from customers on settling the refund liability. Hence, the amount recognised in cost of sales for 97 products is CU5,820 ( $\text{CU}60 \times 97$ ).

## Warranties (paragraphs B10–B15)

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IE19 The following example illustrates the requirements in paragraphs B10–B15  
[IG77] on accounting for the sale of a product with a warranty.

### Example 21—Separate performance obligation for service

A manufacturer grants its customers a warranty with the purchase of a product. The warranty provides a customer with assurance that the product complies with agreed-upon specifications and will operate as promised for three years from the date of purchase. The warranty also gives customers a right of up to 20 hours of training services on how to operate the product. The training services are included with the warranty (ie the customer does not have the option to accept the warranty without the training services).

To account for the warranty, the entity must determine whether any of the warranty should be accounted for as a separate performance obligation. Because the warranty includes the training services that are a service to the customer in addition to assurance that the product complies with agreed-upon specifications, the entity would account for the training services as a separate performance obligation. Hence, the entity would allocate a portion of the total transaction price to that performance obligation. In addition, the entity would account for the assurance-type warranty in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

## Customer options for additional goods or services (paragraphs B20–B24)

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IE20 The following examples illustrate the requirements in paragraphs B20–B22  
[IG78] on determining whether an option provides a customer with a material right.

### Example 22—Option that provides the customer with a material right

An entity enters into a contract for the sale of Product A for CU100. As part of the contract, the entity gives the customer a 40 per cent discount voucher for any future purchases in the next 30 days up to CU100. The entity intends to offer a 10 per cent discount on all sales during the next 30 days as part of a seasonal promotion.

*continued...*

*...continued*

**Example 22—Option that provides the customer with a material right**

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

To allocate a portion of the transaction price to the separate performance obligation for the discount voucher, the entity estimates an 80 per cent likelihood that a customer will redeem the voucher and that a customer will, on average, purchase CU50 of additional products. Because the entity intends to offer a 10 per cent discount to all customers as part of a seasonal promotion, the 40 per cent discount that the customer would obtain when exercising the voucher needs to be reduced by 10 percentage points to 30 per cent to reflect the incremental value of the discount to the customer. Hence, the entity's estimated standalone selling price of the discount voucher is CU12 (CU50 average purchase of additional products × 30% incremental discount × 80% likelihood of exercising the option).

If the stand-alone selling price of Product A is CU100, the entity allocates CU10.7 { $CU100 \times [12 \div (12 + 100)]$ } of the CU100 transaction price to the discount voucher.

**Example 23—Option that does not provide the customer with a material right**

A telecommunications entity enters into a contract with a customer to provide up to 600 call minutes and 100 text messages each month for a fixed monthly fee. The contract specifies the price for any additional call minutes or texts that the customer may opt to purchase in any month.

The entity determines that the customer's fixed monthly payments do not include a prepayment for future services because the prices of the additional call minutes and texts reflect the stand-alone selling prices for those services.

*continued...*

...continued

**Example 23—Option that does not provide the customer with a material right**

Consequently, even though the customer can exercise the option for any additional call minutes and text messages only because it entered into a contract, the option does not grant the customer a material right and, therefore, is not a performance obligation in the contract. Hence, the entity would recognise revenue for additional call minutes and texts only if and when the customer receives those additional services.

IE21 The following example illustrates the requirements in paragraph B23 on  
[IG79] determining the amount of the transaction price to allocate to an option as part of a customer loyalty programme.

**Example 24—Customer loyalty programme**

An entity has a customer loyalty programme that rewards a customer with one customer loyalty point for every CU10 of purchases. Each point is redeemable for a CU1 discount on any future purchases. During a reporting period, customers purchase products for CU100,000 and earn 10,000 points redeemable for future purchases. The stand-alone selling price of the purchased products is CU100,000. The entity expects 9,500 points to be redeemed on the basis of its past experience that it concludes is predictive of the amount of consideration to which it will be entitled. The entity estimates a stand-alone selling price of CU0.95 per point (or CU9,500 total) on the basis of the likelihood of redemption.

The points provide a material right to customers that they would not receive without entering into a contract. Hence, the entity concludes that the points are a separate performance obligation.

The entity allocates the transaction price to the product and the points on a relative stand-alone selling price basis as follows:

	CU
Product	91,324 <sup>a</sup>
Points	8,676 <sup>b</sup>

*continued...*

<sup>a</sup>  $\text{CU}100,000 \times \text{CU}100,000 \div \text{CU}109,500$

<sup>b</sup>  $\text{CU}100,000 \times \text{CU}9,500 \div \text{CU}109,500$

*...continued***Example 24—Customer loyalty programme**

At the end of the first reporting period, 4,500 of the points have been redeemed and the entity continues to expect 9,500 points to be redeemed in total. The entity recognises revenue for the loyalty points of CU4,110  $[(4,500 \text{ points} \div 9,500 \text{ points}) \times \text{CU}8,676]$ .

During the second reporting period, an additional 4,000 points are redeemed (cumulative points redeemed are 8,500). The entity expects that 9,700 points will be redeemed in total. The cumulative revenue that the entity recognises is CU7,603  $[(8,500 \div 9,700) \times \text{CU}8,676]$ . The entity has recognised CU4,110 in the first reporting period, so it recognises revenue for the loyalty points of CU3,493  $(\text{CU}7,603 - \text{CU}4,110)$  in the second reporting period.

In the third reporting period, an additional 1,200 points are redeemed (cumulative points redeemed are 9,700). The entity expects that no additional points will be redeemed. The entity has already recognised revenue of CU7,603 so it recognises the remaining revenue for the loyalty points of CU1,073  $(\text{CU}8,676 - \text{CU}7,603)$ .

IE22 The following example illustrates the requirements in paragraph B24 on  
[IG80] using a practical alternative to determine the amount of the transaction price to allocate to an option for a renewal of annual maintenance services.

**Example 25—Maintenance services with a renewal option**

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

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

*continued...*

...continued

**Example 25—Maintenance services with a renewal option**

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

The entity expects 90 per cent of customers to renew at the end of year 1 and 90 per cent of those customers to renew at the end of year 2.

The entity determines the amount to allocate to the option at the end of years 1 and 2 as follows.

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

Year 1	CU600
Year 2	CU750
Year 3	CU1,000

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

	<i>Expected costs adjusted for likelihood of contract renewal</i>	<i>Allocation of consideration expected</i>
	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)
	<u>2,085</u>	<u>2,710</u>

Therefore, at the end of year 1, the entity allocates to the option CU22,000 of the consideration received to date [cash of CU100,000 – revenue recognised of CU78,000 (CU780 × 100)]. The entity allocates CU24,300 to the option at the end of year 2 [cumulative cash of CU190,000 – cumulative revenue recognised of CU165,700 (CU78,000 + CU877 × 100)].



## Licensing (paragraphs B33–B37)

IE23 The following example illustrates the requirements in paragraphs [IG81] B33–B37 on licensing.

### Example 26—Franchise rights

An entity enters into a contract with a customer and promises to transfer to the customer a right to open a franchise store in a specified location. The store will bear the entity's trade name and the customer has the right to sell the entity's products for five years. The customer promises to pay an upfront, fixed fee and on-going royalty payments of 1 per cent of the customer's quarterly sales. The customer is obliged to purchase products from the entity at their current stand-alone selling prices at the time of purchase. The entity will also provide the customer with employee training and the equipment necessary to be a distributor of the entity's products. Similar training services and equipment are sold separately.

To identify the performance obligations, the entity must determine whether the promised rights, training services and equipment are distinct.

In accordance with paragraph 28, the rights to the trade name, market area and proprietary know-how for five years are not individually distinct because individually they are not sold separately and cannot be used with other goods or services that are readily available to the customer. However, on a combined basis, those rights are distinct because they can be used together with other services that are readily available to the customer. Hence, those combined rights give rise to a separate performance obligation. The entity satisfies the performance obligation to grant those rights at the point in time when the customer obtains control of the rights (ie commencement of operations by the customer).

The training services and equipment are distinct because similar services and equipment are sold separately. The entity satisfies those performance obligations when it transfers the services and equipment to the customer.

The entity's promise to stand ready to provide products to the customer in the future would not be accounted for as a separate performance obligation in the contract because it does not provide the customer with a material right (as described in paragraph B22).

In accordance with paragraph 85, the entity cannot recognise revenue for the royalty payments because the entity is not reasonably assured to be entitled to those sales-based royalty amounts. Hence, the entity recognises revenue for the royalties when (or as) the uncertainty is resolved.

## Appendix

### Amendments to guidance on other IFRSs

*These amendments to guidance on other IFRSs are necessary in order to ensure consistency with the amendments to [draft] IFRS X Revenue from Contracts with Customers. In the amended paragraphs, new text is underlined and deleted text is struck through.*

#### **IFRS 1 *First-time Adoption of International Financial Reporting Standards***

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IGA1 The heading above paragraph IG17 and paragraph IG17 are amended as follows:

#### **IAS 18 [draft] IFRS X Revenue from Contracts with Customers**

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IG17 If an entity has received amounts that do not yet qualify for recognition as revenue in accordance with ~~IAS 18 [draft] IFRS X~~ (for example, the proceeds of a sale that does not qualify for revenue recognition), the entity recognises ~~the amounts received as a~~ contract liability in its opening IFRS statement of financial position and measures that liability at the amount received, adjusted (if appropriate) for the effects of the time value of money in accordance with [draft] IFRS X.

#### **IFRS 3 *Business Combinations***

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IGA2 A footnote is added to the table in the Comparison of IFRS 3 (as revised in 2008) and SFAS 141(R) as follows:

**Comparison of IFRS 3 (as revised in 2008) and SFAS 141(R)**

Assets and liabilities arising from contingencies	<p><b>Subsequent measurement</b></p> <p>The revised IFRS 3 carries forward the existing requirements that a contingent liability recognised in a business combination must be measured subsequently at the higher of the amount that would be recognised in accordance with IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> or the amount initially recognised less, if appropriate, cumulative amortisation recognised in accordance with IAS 18 <i>Revenue</i>*. [paragraph 56]</p>	<p><b>Subsequent measurement</b></p> <p>SFAS 141(R) requires an acquirer to continue to report an asset or liability arising from a contractual or noncontractual contingency that is recognised as of the acquisition date that would be in the scope of SFAS 5 if not acquired or assumed in a business combination at its acquisition-date fair value until the acquirer obtains new information about the possible outcome of the contingency.</p> <p>The acquirer evaluates that new information and measures the asset or liability as follows:</p> <p>(a) a liability is measured at the <i>higher</i> of:</p> <ul style="list-style-type: none"> <li>(i) its acquisition-date fair value; or</li> <li>(ii) the amount that would be recognised if applying SFAS 5.</li> </ul> <p>(b) an asset is measured at the <i>lower</i> of:</p> <ul style="list-style-type: none"> <li>(i) its acquisition-date fair value; or</li> <li>(ii) the best estimate of its future settlement amount. [paragraphs 62 and 63]</li> </ul>
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\*[draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue* and amended paragraph 56 of IFRS 3 for consistency.

## **IFRS 4 Insurance Contracts**

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IGA3 Paragraph IG25 is amended as follows:

### **Definition of insurance contract**

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IG25 ~~IAS 18 [draft] IFRS X~~ requires an entity to ~~disclose the amount of each significant category of revenue recognised during the period, and specifically requires disclosure of revenue arising from the rendering of services~~ disaggregate revenue into categories that best depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Although revenue from insurance contracts is outside the scope of ~~IAS 18 [draft] IFRS X~~, similar disclosures may be appropriate for insurance contracts. The IFRS does not prescribe a particular method for recognising revenue and various models exist:

...

## **IFRS 9 Financial Instruments (November 2009)**

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IGA4 Paragraph IGA12 and the related heading are deleted.

## **IFRS 9 Financial Instruments (October 2010)**

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IGA5 Paragraph IGA20 and the related heading are deleted.

## **IFRS 13 Fair Value Measurement**

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IGA6 Paragraphs IGA14 and IGA15 and the related heading are deleted.

## **IFRIC 12 Service Concession Arrangements**

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IGA7 Paragraphs IE1, IE4, IE5, IE6, IE11, Table 2.1, IE14, IE15, Table 2.2, IE17, IE23, Table 3.1, IE24, Table 3.2, IE31, Table 3.4 and IE33 are amended and table 1.2 is replaced as follows:

IE1 The terms of the arrangement require an operator to construct a road—completing construction within two years—and maintain and operate the road to a specified standard for eight years (ie years

3–10). The terms of the arrangement also require the operator to resurface the road at the end of year 8 ~~the resurfacing activity is revenue generating~~. At the end of year 10, the arrangement will end. Assume that the operator identifies three separate performance obligations for construction services, operation services and road resurfacing. The operator estimates that the costs it will incur to fulfil its obligations will be:

...

- IE4 ~~The operator recognises contract revenue and costs in accordance with IAS 11 Construction Contracts and IAS 18 Revenue [draft] IFRS X Revenue from Contracts with Customers. The costs of each activity—construction, operation and resurfacing are recognised as expenses by reference to the stage of completion of that activity. Contract revenue—the fair value of the amount due of consideration to which the operator expects to be entitled from the grantor for the activity undertaken services provided—is recognised at the same time when (or as) the performance obligations are satisfied. Under the terms of the arrangement the operator is obliged to resurface the road at the end of year 8. In year 8 the operator will be reimbursed by the grantor for resurfacing the road. The obligation to resurface the road is measured at zero in the statement of financial position and the revenue and expense are not recognised in profit or loss until the resurfacing work is performed.~~
- IE5 ~~The total expected consideration (CU200 in each of years 3–8~~10~~) reflects the fair values for each of the services, which are is allocated to the performance obligations based on the relative stand-alone selling prices of the construction services, operation services and road resurfacing, taking into account the time value of money, as follows:~~

**Table 1.2 Transaction price allocated to each performance obligation**

	Transaction price allocation (including effect of the time value of money)
	CU
Construction services (over two years) <sup>(a)</sup>	1,050
Operation services (over 8 years) <sup>(b)</sup>	96
Road resurfacing services (in year 8) <sup>(c)</sup>	110
Total	<u>1,256</u>
Implied interest rate <sup>(d)</sup>	6.18% per year

- (a) The operator estimates the relative stand-alone selling price by reference to the forecast cost plus 5 per cent.
- (b) The operator estimates the relative stand-alone selling price by reference to the forecast cost plus 20 per cent.
- (c) The operator estimates the relative stand-alone selling price by reference to the forecast cost plus 10 per cent.
- (d) The implied interest rate is assumed to be the rate that would be reflected in a financing transaction between the operator and the grantor.

IE6 In year 1, for example, construction costs of CU500, construction revenue of CU525 (~~cost plus 5 per cent~~), and hence construction profit of CU25 are recognised in profit or loss.

IE11 The terms of a service arrangement require an operator to construct a road—completing construction within two years—and maintain and operate the road to a specified standard for eight years (ie years 3–10). The terms of the arrangement also require the operator to resurface the road when the original surface has deteriorated below a specified condition. The operator estimates that it will have to undertake the resurfacing at the end of the year 8. At the end of year 10, the service arrangement will end. Assume that the operator identifies a single performance obligation for construction services. The operator estimates that the costs it will incur to fulfil its obligations will be:

**Table 2.1 Contract costs**

	Year	CU <sup>(a)</sup>
Construction services	1	500
	2	500
<del>Operation services</del> <u>Operating the road</u> (per year)	3–10	10
Road resurfacing	8	100

(a) in this example, monetary amounts are denominated in 'currency units (CU)'.

IE14 The operator provides construction services to the grantor in exchange for an intangible asset, ie a right to collect tolls from road users in years 3–10. In accordance with ~~IAS 38 Intangible Assets~~, ~~the operator recognises the intangible asset at cost, ie the fair value of consideration transferred to acquire the asset, which is the fair value of the consideration received or receivable for [draft] IFRS X.~~ the operator measures this non-cash consideration at fair value, which in this case it determines indirectly by reference to the stand-alone selling price of the construction services delivered.

IE15 During the construction phase of the arrangement the operator's asset (representing its accumulating right to be paid for providing construction services) is classified as an intangible asset (licence to charge users of the infrastructure). The operator estimates the ~~fair value of its consideration received~~ stand-alone selling price of the construction services to be equal to the forecast construction costs plus 5 per cent margin. It is also assumed that, in accordance with IAS 23 *Borrowing Costs*, the operator capitalises the borrowing costs, estimated at 6.7 per cent, during the construction phase of the arrangement:

**Table 2.2 Initial measurement of intangible asset**

	CU
Construction services in year 1 ( $CU500 \times (1 + 5\%)$ )	525
Capitalisation of borrowing costs (table 2.4)	34
Construction services in year 2 ( $CU500 \times (1 + 5\%)$ )	525
<b>Intangible asset at end of year 2</b>	<u>1,084</u>

- IE17 The operator recognises the revenue ~~and costs~~ in accordance with ~~IAS 11 Construction Contracts, ie by reference to the stage of completion of the construction~~ [draft] IFRS X. It measures contract revenue at the fair value of the non-cash consideration received or receivable. Thus in each of years 1 and 2 it recognises in its profit or loss construction costs of CU500, construction revenue of CU525 (~~cost plus 5 per cent~~) and, hence, construction profit of CU25.
- IE23 The terms of a service arrangement require an operator to construct a road—completing construction within two years—and to operate the road and maintain it to a specified standard for eight years (ie years 3–10). The terms of the arrangement also require the operator to resurface the road when the original surface has deteriorated below a specified condition. The operator estimates that it will have to undertake the resurfacing at the end of year 8. At the end of year 10, the arrangement will end. Assume that the operator identifies a single performance obligation for construction services. The operator estimates that the costs it will incur to fulfil its obligations will be:

**Table 3.1 Contract costs**

	Year	CU
Construction services	1	500
	2	500
<del>Operation services</del> <u>Operating the road</u> (per year)	3–10	10
Road resurfacing	8	100

- IE24 The operator estimates the consideration in respect of construction services to be CU1,050 by reference to the stand-alone selling price of those services (which it estimates at forecast cost plus 5 per cent).



**Table 3.2 Dividing the operator's consideration**

Year	Total	Financial asset	Intangible asset
Construction services in year 1 ( $\text{CU}500 \times (1 + 5\%)$ )	525	350	175
Construction services in year 2 ( $\text{CU}500 \times (1 + 5\%)$ )	525	350	175
Total construction services	1,050	700	350
	100%	67% <sup>(a)</sup>	33%
Finance income, at specified rate of 6.18% on receivable (see table 3.3)	22	22	-
Borrowing costs capitalised (interest paid in years 1 and 2 $\times$ 33%) (see table 3.7)	11	-	11
Total fair value of the operator's consideration	1,083	722	361

(a) Amount guaranteed by the grantor as a proportion of the construction services.

IE31 During the construction phase of the arrangement the operator's asset (representing its accumulating right to be paid for providing construction services) is classified as a right to receive a licence to charge users of the infrastructure. The operator estimates the ~~fair value of its consideration received or receivable~~ stand-alone selling price of the construction services as equal to the forecast construction costs plus 5 per cent. It is also assumed that, in accordance with IAS 23 *Borrowing Costs*, the operator capitalises the borrowing costs, estimated at 6.7 per cent, during the construction phase:

**Table 3.4 Initial measurement of intangible asset**

	CU
Construction services in year 1 ( <del><math>\text{CU}500 \times (1 + 5\%) \times 33\%</math></del> )	175
Borrowing costs (interest paid in years 1 and 2 $\times$ 33%) (see table 3.7)	11
Construction services in year 2 ( <del><math>\text{CU}500 \times (1 + 5\%) \times 33\%</math></del> )	175
<b>Intangible asset at the end of year 2</b>	<b>361</b>

IE33 The operator provides construction services to the grantor in exchange for a financial asset and an intangible asset. Under both the financial asset model and intangible asset model, the operator recognises contract revenue ~~and costs~~ in accordance with ~~[draft] IFRS X IAS 11 Construction Contracts, ie by reference to the stage of completion of the construction. It measures contract revenue at the fair value of the consideration receivable.~~ Thus in each of years 1 and 2 it recognises in profit or loss construction costs of CU500 and construction revenue of CU525 ~~(cost plus 5 per cent).~~